IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

77-325

NASHVILLE GAS COMPANY,
Petitioner,

v.

TENNESSEE PUBLIC SERVICE COMMISSION, *ET AL.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

Nashville Gas Company ("Nashville") hereby petitions the Court for a writ of certiorari to review the judgments of the Supreme Court of Tennessee in this case.

OPINIONS BELOW

The Opinion of the Tennessee Supreme Court (App. E, *infra*, pp. A17-A29) is reported at 551 S.W.2d 315 (1977). The Order of the Tennessee Public Service Commission ("TPSC") (App. O, *infra*, pp. A87-A136) is reported at 11 P.U.R. 4th 442. The Opinion and Order of the Chancery Court, Part One, at Nashville, Tennessee (App. H, *infra*, pp. A32-A34), on appeal by Nashville of the TPSC's Initial Opinion and Order, is not and will not be, reported.

JURISDICTION

The judgment of the Supreme Court of Tennessee (App. E, *infra*, pp. A17-A29) was entered on March 21, 1977. Petitioner Nashville's timely petition for rehearing was denied on May 31, 1977 (App. B, *infra*, p. A3). By Order entered June 2, 1977, the judgment of the Supreme Court of Tennessee was stayed pending filing of and action on the instant petition for certiorari (App. A, *infra*, pp. A1-A2). The jurisdiction of this Court is invoked under 28 U.S.C. 1257(3).

QUESTIONS PRESENTED

1. Does the Supreme Court of Tennessee's decision conflict with the Fifth and Fourteenth Amendments to the Constitution of the United States, in holding that rates which Petitioner, an intrastate gas distribution company, may charge its customers, should be reduced by the net income derived by Petitioner's parent company from long-standing, negotiated contracts for interstate sales to three direct industrial customers of the parent, which the Court below found were made by the parent for legitimate business reasons, where: the parent was not a party to the proceeding; its rates to those customers were not attempted to be regulated by the state; and, the Court below expressly found good faith, an absence of overreaching, and no reason for piercing the corporate veil?

2. Does the Supreme Court of Tennessee's holding, imputing to the regulated utility net profits of its parent, conflict with this Court's decisions in *Smyth v. Ames*, 69 U.S. 466 at 541-542 (1898), and subsequent cases to the effect that the "reasonableness . . . of rates prescribed by a state for [utility services] wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it?"

3. Is the Supreme Court of Tennessee's decision, appropriating revenues of the parent in reduction of the subsidiary's rates, unrelated to the subsidiary's investment, costs or rate of return, confiscatory and a denial of substantive and procedural due process, in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States?

4. Does the decision of the Tennessee Supreme Court conflict with the Natural Gas Act and the jurisdiction of the Federal Power Commission ("FPC") with respect to the regulation of interstate gas companies and the fixing of wholesale rates?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Clause 3, Section 8, of Article I of the Constitution of the United States provides that the Congress shall have power:

> "3. To regulate commerce with foreign nations, and among the several States, and with the Indian tribes."

Article V of the Amendments to the Constitution of the United States provides:

> "...nor shall private property be taken for public use without just compensation."

Article XIV of the Amendments to the Constitution of the United States provides:

> "...nor shall any State deprive any person of life, liberty, or property without due process of law, ..."

The Natural Gas Act, 52 Stat. 821, *et seq.*, as amended, 15 U.S.C. 717, *et seq.*, provides in pertinent part:

Section 1(b), 15 U.S.C. 717(b):

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce,

to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

Sections 2(6) and 2(7), 15 U.S.C. 717(a):

"(6) 'Natural-gas company' means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

"(7) 'Interstate commerce' means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States."

Section 4(a), 15 U.S.C. 717c(a):

"(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

Section 7(c), 15 U.S.C. 717f(c):

"No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension, shall engage in

the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations; . . . ."

"In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly; . . . ."

Section 7(e), 15 U.S.C. 717f(e):

"(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such

reasonable terms and conditions as the public convenience and necessity may require. [56 Stat. 84 (1942); 15 U.S.C. §717f(e)]"

STATEMENT OF THE CASE

Summary and Background

Petitioner, Nashville, is a distributor of natural gas in Nashville, Davidson County, Tennessee, and in certain portions of the surrounding contiguous Tennessee counties of Cheatham, Wilson, Williamson and Sumner. In 1945, it was acquired by its present parent corporation, Tennessee Natural Gas Lines, Inc. ("TNGL"). It is an intrastate company totally regulated by the TPSC. It purchases its entire supply of natural gas from TNGL under rates and conditions of service totally regulated by the FPC.

TNGL is a "natural-gas company" (an interstate company) as defined in the federal Natural Gas Act, *supra,* p. 3–6, and as such is regulated by the FPC as to all aspects of its operations, with the single exception of the *rates* at which it makes sales to three direct industrial customers located within the state of Tennessee. Such sales are made pursuant to certificates of public convenience and necessity authorizing the specific sales and conditions of service thereof, issued by the FPC in its Docket Nos. G-1381 (issued in 1950), G-9696 (issued in 1956), and G-18503 (issued in 1959). TNGL was first held to be a "natural-gas company" subject to regulation by the FPC by that commission's Order issued December 29, 1945 in its Docket No. G-575. Subsequently, it has been repeatedly so held, including, among others, the orders authorizing service to its three direct industrial customers, above. Each of such orders held such sales to be in interstate commerce and subject to FPC's jurisdiction.

The instant petition for certiorari arises from the holding by the Supreme Court of Tennessee that it was permissible for

the TPSC, in establishing the rates to be charged by Nashville to its customers, to impute to Nashville the net income of Nashville's parent, TNGL, from the parent's sales to TNGL's direct industrial customers as a direct reduction in Nashville's revenues designed to recover the cost of serving Nashville's customers, even though the Court found that Nashville and its parent had had separate historical development, had been formed for and performed different purposes, that such purposes were legitimate, and that there was "...no evidence whatever of any misconduct, illegality or impropriety in any of the management decisions and transactions which are reflected in this record."

Such finding by the Tennessee Court was required by the evidence before it. Nashville has been engaged in distributing gas in Nashville, Tennessee since prior to 1918. At the time TNGL acquired the outstanding common stock of Nashville, Nashville was distributing manufactured gas through an obsolete cast iron system in only a limited portion of the downtown business district of the City of Nashville. The holding company which then owned it had tried unsuccessfully for several years to sell Nashville under a divestiture order. The City of Nashville had refused to buy the company. TNGL had the contract franchise rights to the area from the interstate natural gas pipeline which constituted the only source of natural gas to the area. TNGL acquired the common stock of Nashville and arranged to provide a supply of natural gas to it, which enabled Nashville to begin rehabilitating and expanding its distribution system so as to render adequate service to its existing customers and service to larger areas. At the time the three direct industrial customers were attached to TNGL's system, rehabilitation and expansion activities were requiring Nashville's total financial capabilities and it could not have financed facilities necessary to attach such customers.

Although TNGL owns all of the outstanding common stock of Nashville, Nashville and TNGL each have debt financing totally separate and distinct from the debt financing of the other. Nashville's debtholders thus can look only to

Nashville's own revenues for service of such debt. Since TNGL cannot be required to actually give to Nashville the revenues imputed to it, the result of the Tennessee Court's holding is only that Nashville's revenues are to be reduced by such amount and the security of Nashville's debtholders will be impaired. Since TNGL's debtholders can look only to TNGL's earnings, their security has been impaired because the reduction in Nashville's revenues will reduce or totally eliminate any dividends on Nashville's common stock which constitutes one of the elements of TNGL's total earnings. At no time was TNGL or the debtholders of either Nashville or TNGL parties to the proceedings.

As shown hereinafter, it is and has been Nashville's position throughout that such holding violates the Fifth and Fourteenth Amendments to the Constitution of the United States in that it confiscates Nashville's and its parent's property for public use without just compensation or due process of law; that it violates the rights guaranteed by such Amendments to Nashville's debtholders and to the debtholders and stockholders of TNGL as well as TNGL itself; and, that it violates Clause 3, Section 8, of Article I of the Constitution of the United States in that it results in state usurpation of a federal power.

Procedural History

On January 15, 1975, Petitioner, Nashville, filed with the TPSC a petition to place into effect an emergency increase in rates solely to permit it to re-finance $10,000,000 of first mortgage bonds to become due on August 1, 1975. In its filing, Nashville made clear that such proposed emergency rates would not provide it with a just and reasonable rate of return–only with the minimum revenues necessary for such re-financing–and that Nashville would subsequently file further revised rates adequate to provide a just and reasonable rate of return. A hearing on Nashville's emergency petition was held by the TPSC on February 12, 1975. By its Order entered in its Docket No. U-6098 on March 13, 1975, the TPSC allowed rates to go into effect on such date, under bond subject to refund, designed to

yield approximately 1.7 million dollars in additional annual revenues. (App. P, *infra*, pp. A137-A140).

Subsequently, on April 14, 1975, Petitioner, Nashville, filed a general rate increase at TPSC Docket No. U-6142 designed to yield revenues sufficient to recover its costs of rendering service, including a just and reasonable rate of return. Upon motion of TPSC staff counsel, the emergency rate proceeding at TPSC Docket No. U-6098 and the general rate increase proceeding at Docket No. U-6142 were consolidated.

Hearings in the consolidated proceedings concerning Nashville's rates were held before the TPSC on 13 days during the period September 3 through October 1, 1975. On October 14, 1975, the TPSC issued its Order (App. O, *infra*, pp. A87-A136) wherein (to the extent here relevant) it:

1. found that Nashville was entitled to a rate of return on common equity capital of 13.5% with a resulting overall rate of return on rate base of 12.14%;

2. found that Nashville has "a need for net operating income of $3,357,636" and that "since the company has rates under bond that will produce gross revenues of $1,909,088, this would require an additional $1,147,044 in gross revenues over the bonded revenues;" and,

3. ordered that Nashville file revised rates to recover the $1,909,088 annually, which it found would be recovered by the emergency rates in effect under bond, plus an additional $1,147,044 annually to which it had found Nashville entitled, *less the effect of imputing to Nashville the net income derived by Nashville's parent company (TNGL) from the parent's sales of natural gas in interstate commerce to the parent's three direct industrial customers.*

One of the three TPSC Commissioners dissented to the opinion and order of the majority to the extent that the same ordered imputation to Nashville's intrastate revenues of the net profits from Nashville's parent's sales in interstate commerce to its own three direct industrial customers. His dissent was basically premised upon the same grounds propounded by Nashville in support of this petition for certiorari, *i.e.*, that the TPSC did not have the authority to order such imputation because it resulted in: an attempted requirement that revenues from interstate commerce be used to subsidize costs of rendering intrastate service (aside from the fact that separate corporate entities are involved); and, resulted in confiscation and deprivation of property contrary to the provisions of the Constitution of the United States.

On December 1, 1975, Nashville filed with the Chancery Court, Part One, at Nashville, Tennessee (the court of competent jurisdiction) its Original Bill of Complaint and Petition for Certiorari (App. N, *infra*, pp. A52-A86) seeking reversal of the TPSC's October 14, 1975 Order, the grounds for which, to the extent here relevant, were the same as those it urges here. Nashville also sought a temporary injunction against enforcement of TPSC's order and the right to put into effect under bond the rates sought by it before the TPSC. After a preliminary hearing the Chancellor, by Memorandum Opinion dated December 23, 1975 incorporated into his decree entered January 29, 1976 (App. L, *infra*, pp. A47-A48), denied the requested temporary relief and suggested that, due to the nature of the claim, the proceeding should be set for hearing at the earliest possible date. By Order entered January 29, 1976, the Chancellor denied Nashville's motion for reconsideration.

The case was fully heard on the merits by the Chancellor on February 26, 1976 and the Court's Memorandum Opinion was entered on March 24, 1976 (App. I, *infra*, pp. A35-A43). A final decree was entered on April 5, 1976 (App. H, *infra*, pp. A32-A34) based upon such Memorandum Opinion. Insofar as here relevant, the Chancellor reversed TPSC's October 14, 1975 Order to the extent that it required imputation to Nashville's

intrastate revenues of its parent company's interstate net profits, for the same basic reasons urged herein by Nashville.

The TPSC timely filed its appeal of the Chancellor's Order to the extent that it upheld Nashville's position on the imputation issue and another issue not here involved. After briefing and oral argument, on March 21, 1977 the Tennessee Supreme Court issued its Opinion (App. E, *infra*, pp. A17-A29) reversing the Chancellor as to such two issues. It held that the TPSC could constitutionally impute to Nashville the net revenues from sales in interstate commerce by Nashville's parent in prescribing Nashville's intrastate rates. By its Order entered May 31, 1977 (App. B, *infra*, p. A3), the Tennessee Supreme Court denied Nashville's petition for rehearing which had been timely filed. By its Order entered June 2, 1977, the Tennessee Supreme Court granted Nashville's application for stay pending this Court's disposition of Nashville's instant petition for certiorari.

In its March 21, 1977 Opinion, the Tennessee Supreme Court held that the net income from Nashville's parent's sales in interstate commerce could be imputed to Nashville's intrastate revenues as a subsidy to Nashville's costs of rendering intrastate service to its customers. The Tennessee Court approved as a principle that subsidization of the costs of rendering intrastate service by net income from interstate sales of a separate parent company can constitutionally be required even though it explicitly held:

> "... because of certain statements and comments made in the briefs and in the record, we feel constrained to state that we find no evidence whatever of any misconduct, illegality or impropriety in any of the management decisions and transactions which are reflected in this record."(App. E, *infra*, p. A23)

and again:

"There is no question but that the two companies have had in the past separate historical development, and we have already stated that we find no illegality whatever in the management decisions which resulted in the present situation." (App. E *infra*, p. A26)

The Tennessee Court jumped from the premise, that since this Court held in *Panhandle Eastern Pipeline Company v. Public Service Commission of Indiana*, 332 U.S. 507, 68 S.Ct. 190, 92 L.Ed.128 (1947) that a state could constitutionally regulate the *rate* at which an interstate pipeline makes direct industrial sales under the doctrine of pre-emption, to the conclusion that a state can constitutionally require that such interstate sales subsidize the costs of intrastate service. The Tennessee Supreme Court omitted the second premise involved in the syllogism and equated the right to regulate the rate with the right to require subsidization. The two are far different matters.

The regulation of a rate is the establishment of the price to be charged to the customer paying the rate. Here, the TPSC has never sought to establish the rate to be charged to TNGL's three direct industrial customers and has never in any way attempted to regulate such rates. Instead, it sought to leave such rates unregulated but to use the net income derived therefrom as an offset against the costs of rendering intrastate service to different customers of another company.

Although the TPSC attempted, and the Tennessee Court approved as a principle, a requirement that interstate revenues of a parent company be used to subsidize the cost of rendering intrastate service by a subsidiary company, the effect of the decision is not that at all. Since there is no mechanism by which Nashville can obtain from TNGL the revenues of TNGL imputed to Nashville except as an outright gift, the effect of what the Tennessee Court has approved is a reduction in the revenues of Nashville to a level substantially below that which the TPSC found to be necessary in order for Nashville to

recover its cost of rendering service, including the rate of return found to be required. The holding has the effect of sheer subterfuge.

Pursuant to Rule 23 1(f), Nashville submits the following with respect to its timely raising of the federal questions presented. Although during the hearing before the TPSC, TPSC staff asked numerous questions relating to the interstate operations of Nashville's parent, Nashville's numerous objections to which were overruled, and although the major portion of the hearing before the TPSC related to the parent's operations, neither Nashville, TNGL, nor their debtholders or shareholders, had any reason to suspect that the TPSC would adopt the attempted subsidization procedure which it did. None of such parties except Nashville were parties to the proceeding.

In its Original Bill of Complaint and Petition for Certiorari to the Chancery Court (App. N, *infra*, pp. A52-A86), Nashville specifically raised the federal questions here involved (both constitutional and statutory) as its primary grounds of error. It even sought an injunction on such grounds. The Chancellor denied injunctive relief but ruled for Nashville on the federal questions involved (App. H, *infra*, pp. A32-A34).

TPSC's appeal to the Tennessee Supreme Court complained primarily of the Chancellor's holdings on the federal questions. The briefing and oral argument before the Tennessee Supreme Court related almost exclusively to such federal questions. Nashville's arguments in brief, oral argument, and petition for rehearing (App. D, *infra*, pp. A5-A16) all raised the federal issues raised in this petition.

Nashville's timely raising of the federal issues is obvious from all the opinions and decisions in the case.

REASONS FOR GRANTING THE WRIT

The narrow issue in this case, which Petitioner requests that this Court review, is whether, in a ratemaking proceeding

involving only the Petitioner, to which its parent is not a party—and in which the rates charged by the parent are not at issue and are not and cannot be affected by the TPSC's Order—the TPSC may, nevertheless, treat the net revenues of the parent, derived from non-jurisdictional, interstate sales to three customers, as if they were revenues of the subsidiary for purposes of fixing the subsidiary's rates. As the Tennessee Supreme Court explicitly found, no fraud, overreaching or other circumstances exist for "piercing the corporate veil," and the Court does not rest its decision upon any such doctrine. The sole question is whether—without asserting or exercising comprehensive rate-regulatory jurisdiction over the rates charged by the parent to its industrial customers—the TPSC may merely, by fiat, and totally apart from even any gesture towards observance of rate-regulatory requirements, impute the net interstate revenues of the parent to its intrastate subsidiary.

The decision in the present case is unprecedented. In all rate proceedings—for example, in the familiar example of telephone rates—state commissions fix local rates on the basis of an allocation of costs and revenues to the local service. No commission in any field of public utility regulation, has, until the present case, attempted to fix local rates over which it exercises jurisdiction, by imputing to the revenues of the local operation the net revenues of the interstate operation over which it is not exercising, and has not attempted to exercise, rate jurisdiction. In the few cases where a state commission has attempted analogous action, this Court has consistently struck them down, *e.g., Smyth v. Ames.*

The Tennessee Supreme Court's Holding Is Contrary To Consistent Holdings by This Court, Violates Petitioner's Constitutional Rights

The decision of the Supreme Court of Tennessee is contrary to the consistent rulings of this Court and to accepted principles of utility rate-regulation; it is confiscatory, and it violates constitutional guaranties of substantive and procedural due process.

It is settled law that public utility rates are confiscatory if they result in a denial of a fair return on assets used and useful in providing the regulated service. The Tennessee Supreme Court has itself so held. In *So. Bell T. & T. Co. v. Pub. Serv. Comm.,* 202 Tenn. 465, 304 S.W.2d 640 (1967), the Tennessee Court, citing *Smyth v. Ames, infra,* stated:

> "It has long been established that when a Commission or a legislative branch of the government fixes rates that a utility may charge that it must fix fair rates of return to both utility and to the consumer of the product furnished by the utility. *When these rates are fixed so low that the utility cannot get a fair return this amounts to the taking of property for public use without just compensation and is confiscatory. Smythe v. Ames,* 169 U.S. 466, 18 S. Ct. 418, 42 L.Ed. 819." (Emphasis Added)

It is, of course, true, that in determining the costs and revenues of the utility for rate-regulation, the state may take into account such items as improper or excessive charges made by a parent or affiliated company and excessive payments made by the regulated entity to an affiliate. But that is *not* this case and could not be, because the FPC totally regulates such transactions between Nashville and TNGL. Here, the Tennessee Supreme Court arbitrarily imputed to Petitioner profits derived by its parent from the parent's separate business which, as the Court explicitly determined, the parent conducted as a result of honest, pragmatic business decisions, without fraud or overreaching. In principle, this is directly contrary to *Smyth v. Ames, infra,* and subsequent cases which, without exception, hold, for example, that it is constitutionally impermissible to fix unreasonably low rates on regulated, intrastate service on the basis of profits earned in interstate traffic.

In *Smyth v. Ames,* 169 U.S. 466, 42 L.Ed. 819, 18 S.Ct. 418 (1898), this Court stated:

"It is further said, in behalf of the appellants, that the reasonableness of the rates established by the Nebraska statute is not to be determined by the inquiry whether such rates would leave a reasonable net profit from the local business affected thereby, but that the Court should take into consideration, among other things, the whole business of the company, that is, all its business, passenger and freight, interstate and domestic. If it be found upon investigation that the profits derived by a railroad company from its interstate business alone are sufficient to cover operating expenses on its entire line, and also meet interest, and justify a liberal dividend upon its stock, may the legislature prescribe rates for domestic business that would bring no reward and be less than the services rendered are reasonably worth? Or, must the rates for such transportation as begins and ends in the state be established with reference solely to the amount of business done by the carrier wholly within such state, to the cost of doing such local business, and to the fair value of the property used in conducting it, without taking into consideration the amount and cost of its interstate business, and the value of the property employed in it? If we do not misapprehend counsel, their argument leads to the conclusion that the state of Nebraska could legally require local freight business to be conducted even at an actual loss, if the company earned on its interstate business enough to give it just compensation in respect of its entire line and all its business, interstate and domestic. We cannot concur in this view. *In our judgment, it must be held that the reasonableness or unreasonableness of rates prescribed by a state for the transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it. The state cannot justify unreasonably low rates for domestic transportation, considered alone,*

upon the ground that the carrier is earning large profits on its interstate business, over which, so far as rates are concerned, the state has no control. Nor can the carrier justify unreasonably high rates on domestic business upon the ground that it will be able only in that way to meet losses on its interstate business. So far as rates of transportation are concerned, domestic business should not be made to bear the losses on interstate business, nor the latter the losses on domestic business." 169 U.S. at 541, 542. (Emphasis Added)

This Court reaffirmed the principle in *Simpson v. Shepard*, 230 U.S. 352, 57 L.Ed. 1511, 33 S.Ct. 729 (1913). It stated:

"Where the business of the carrier is both interstate and intrastate, the question whether a scheme of maximum rates fixed by the State for intrastate transportation affords a fair return must be determined by considering separately the value of the property employed in the intrastate business and the compensation allowed in that business under the rates prescribed.... The reason, as there stated, is that the State cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business, and, on the other hand, the carrier cannot justify unreasonably high rates on domestic business because only in that way is it able to meet losses on its interstate business." 230 U.S. at 435, 436.

The principle again was affirmed by this Court in *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 51 S.Ct. 65, 75 L.Ed. 255 (1930), in which this Court stated:

"The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to

> two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation... *The Commission would have had no authority to impose intrastate rates, if as such they would be confiscatory, on the theory that the interstate revenue of the Company was too small and could be increased to make good the loss.*" 282 U.S. at 149 (Emphasis Added)

This Court has consistently applied the principle that interstate costs, revenues, and operations must be separated from intrastate ones in setting the rates of either type of service, specifically so as to prevent the type of subsidization approved by the Tennessee Court. This Court has never retreated from nor diluted the impact of such principle. The recent cases deal not with whether separation is required but, instead, with the issue of the proper mechanics therefor so as to make certain that there is no subsidization of one type of service by the other.

The unjust and confiscatory effect is gross and apparent in this case where the "net profits" of the parent's separate, independent business is confiscated by attribution to the regulated subsidiary without any reference whatever to the effect upon the solvency of either company. Its net effect is to deprive the subsidiary, Petitioner, of revenues which the TPSC found essential for a fair rate, since Petitioner cannot compel the parent to remit the "net profits" in question to it; and, to deprive the parent of the dividend income to which it is entitled from its subsidiary, if a fair return on investment were allowed the subsidiary.

This is not a case where the state is regulating the rates of both parent and subsidiary. The state is not here engaged in rate-regulation of the entire enterprise, assuming it could do so, which it cannot. That would involve a determination of investment, costs, fair return, etc., on the entire business subject to rate-regulation. Without a pretense of doing so–without any

attempt to exercise jurisdiction over the parent–the state has here baldly, boldly, and arbitrarily, in effect, confiscated revenues of the parent and attributed it to the subsidiary. The parent is not a party to this proceeding and has had no opportunity to be heard, nor has the same opportunity been presented to it or to its public bondholders, for example, whose property is being appropriated.

The State Court Misconstrued the Federal Natural Gas Act and Opinions Of This Court Interpreting It And Attempted to Ursurp Federal Authority

The Tennessee Court seems to have sought support for its cavalier disregard of the separate entities of TNGL and Nashville and of the jurisdiction of the FPC by, in effect, asserting that the direct industrial sales made by Nashville's parent corporation are not made in interstate commerce or, if so, not to the extent to bring them within the commerce clause of the Constitution of the United States. It made the statement (App. E, *infra*, pp. A17-A29) that the parent

> ". . . corporation is a 'natural gas company' within the meaning of the federal Natural Gas Act of 1938, but it is such *only* because it sells natural gas to its wholly-owned subsidiary, Nashville Gas Company, for resale." (Emphasis Added)

The Tennessee Court confused the limitation upon the rate-making jurisdiction conferred upon the FPC by the Natural Gas Act, *supra* (which specifically withholds jurisdiction to determine rates for direct sales made by a company subject to FPC regulation) with the definition of "interstate commerce" and what companies and operations are subject to FPC jurisdiction. The fact is that the FPC has specifically exercised its interstate commerce jurisdiction by issuing certificates of public convenience and necessity with respect to TNGL and the three direct industrial sales involved here.

Section 2(6) of the Natural Gas Act, *supra*, p. 4, defines a "natural-gas company" subject to FPC jurisdiction as a person engaged in the transportation of natural gas in interstate commerce *or* the sale in interstate commerce of such gas for resale. Section 2(7), *supra*, p. 4, defines "interstate commerce," *inter alia*, as commerce between any point in a state and any point outside thereof. In *Federal Power Commission v. East Ohio Gas Co.*, 338 U.S. 464, 94 L.Ed. 268, 70 S.Ct. 266 (1950), this Court held that a company like Nashville's parent corporation, which obtains gas from outside the state but is located wholly within a single state, is, nevertheless, engaged in interstate commerce and is subject to the jurisdiction of the FPC. Consequently, Nashville's parent corporation is and since its inception has been fully regulated by the FPC with the lone exception of the *rates* at which it makes direct industrial sales. All matters relating to such sales, except rates, are fully regulated by the FPC.

The Tennessee Court misconstrued two holdings by this Court. In *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 68 S.Ct. 190, 92 L.Ed. 128 (1947), this Court held that a state could constitutionally regulate the *rates* at which an interstate pipeline makes direct industrial sales because such rates are not regulated by the federal government. To like effect is this Court's holding in *Panhandle Eastern Pipe Line Company v. Michigan Public Service Commission*, 341 U.S. 329, 71 S.Ct. 777, 95 L.Ed. 993 (1951). In both such cases, this Court specifically held such sales to be in interstate commerce but that, because the federal government did not regulate the specific incidents involved, the state could constitutionally do so to that limited extent. These cases had nothing whatever to do with the question of whether or not a state can ignore the existence of the interstate company, the federal Natural Gas Act, the jurisdiction of the FPC, or whether a state can constitutionally require subsidization of intrastate costs by interstate revenues. The Tennessee Court interpreted the cases as being tantamount to holdings that such sales are not in interstate commerce and, secondly, that such cases permitted the subsidization, thus reversing *Smyth v. Ames*, *supra*, and the consistent holdings of this Court following such case.

In *Federal Power Commission v. Louisiana Power & Light Co.*, 406 U.S. 621, 32 L.Ed.2d 369, 92 S.Ct. 1827, this Court made it absolutely clear that direct industrial sales are in interstate commerce and that there is an extremely narrow and restricted limitation on the FPC's jurisdiction with respect to such sales (and consequent area in which states can constitutionally act) when it said:

> "Thus, Congress' grant of rate jurisdiction as to sales for resale and the prohibition as to direct sales were meant to apply exclusively to rate-setting, and in no way limited the broad base of 'transportation' jurisdiction granted the FPC." 406 U.S. at 641.

At no time has the state of Tennessee sought to regulate the rates at which Nashville's parent corporation makes direct industrial sales. Instead, it seeks to reduce the amount of the intrastate costs which Nashville can recover through its rates, and to which the state has found Nashville to be entitled, by the amount of net income received by the parent from the interstate direct industrial sales made by it. Such attempted required subsidization is totally different and a far cry from an attempt to regulate the rates at which the parent makes direct industrial sales. The state's action has no relation to setting the rates for the parent's direct industrial sales. Instead, it is purely a sham to disguise an attempt to prevent Nashville from recovering the costs of intrastate service which the state has found Nashville to be entitled to recover.

The Tennessee Court expressed concern that, absent a state's power to require subsidization of intrastate costs by interstate revenues, an interstate natural-gas company could manipulate markets as between itself and an intrastate subsidiary contrary to the public interest, although the Court specifically found that such was not the case here. We would point out the following as showing that the same could never occur. The Tennessee Court totally misapprehends the scope and operation of the federal Natural Gas Act, *supra*, pp. 3–6. The Natural Gas Act and the FPC's jurisdiction thereunder

totally prohibit such a result. Section 7 of the Natural Gas Act provides that an interstate natural-gas company cannot commence, cease, or change the terms of service to its customers without first obtaining FPC authorization. The Act provides that the FPC cannot issue such authorization unless it finds, after hearing, that such service or change therein is required by the public convenience and necessity. The Act requires public notice of any such proposal and allows state commissions or any other person having an interest therein to participate in any hearings relating thereto. The FPC has consistently held that, included within the standard of public convenience and necessity, are the issues of whether or not the proposed service should be rendered at all and, if so, upon what terms and conditions, and by whom, *i.e.*, whether by the applicant interstate natural-gas company or by some other entity (including intrastate customers of the interstate natural-gas company). All of the direct industrial service rendered by Nashville's parent was authorized by the FPC pursuant to the foregoing procedures. No party, including the state of Tennessee, even suggested that such direct industrial service could or should be rendered by Nashville rather than by its parent corporation.

If left standing, the effect of the Tennessee Court's holding will be to negate and invalidate other findings and orders of the FPC issued pursuant to its jurisdiction under the Natural Gas Act, *supra*, pp. 3–6. Sections 4 and 5 of the Act require that the FPC prescribe the "just and reasonable" rates to be charged by interstate natural-gas companies for their sales for resale–in Nashville's parent's case, the rates Nashville pays. In setting such rates, the FPC determines the total costs (including return on investment) of rendering the service. It then allocates such total costs between jurisdictional (resale) and non-jurisdictional (direct industrial) service on the basis of cost responsibility (*i.e.*, the class for whose benefit such costs were incurred). It makes such allocations and assignments of costs so as to comply with this Court's consistent holdings that one class must not subsidize the other. It then establishes resale rates based only on the costs allocated and assigned to the resale services. The non-jurisdictional or direct industrial service is left to private

non-jurisdictional or direct industrial service is left to private contract negotiations between the natural-gas company and its direct industrial customers in the absence of state regulation of such rates. If the natural-gas company is able to negotiate rates with its direct industrial customers higher than the costs assigned thereto by the FPC, then the natural-gas company earns more from such service than its costs. Conversely, if it is unable to negotiate rates sufficient to recover the costs allocated by the FPC to such service, it loses money. In either event, its gains or losses from the direct industrial service is supposed to have no effect on the resale costs or revenues.

In any event, the starting point is the determination of the total costs of the interstate company allowable and assignable to the two classes of service. In setting the rates for jurisdictional resale service, the FPC determines those costs to be borne by such service. The subsidization approved by the Tennessee Court has the effect of reducing the costs so determined by the FPC, as properly to be borne by such service, by the amount of the subsidy and negates the FPC's findings and orders to that extent. The TPSC's action in this case totally avoids the procedures established by law to safeguard the FPC's jurisdiction. By the device of merely "imputing" TNGL's profits to petitioner, and correspondingly *reducing* petitioner's retail rates, the TPSC has achieved exactly the same result as it would have had it overtly disallowed a portion of the FPC-approved wholesale rate from petitioner's parent's operating expenses. It achieves this result indirectly by purporting to look at TNGL's direct sales profits, rather than at the FPC-approved wholesale profits, but the substance and effect of the TPSC's actions are precisely the same in either case.

Permitting the TPSC to employ the "short cut" procedures as it did in this case, rather than the usual procedures for utility regulation established by law, makes it wholly impossible for this or any other Court to know whether the TPSC is in fact "second guessing" the FPC's regulation of TNGL's wholesale rates. And, of course, it is well established that a state PSC may not, as a constitutional matter, use its powers directly or

indirectly to "second guess" the FPC's exercise of its natural gas rate regulation powers. *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F.Supp. 522 (W.D. Ok. 1973), aff'd per curiam 415 U.S. 961, 94 S.Ct. 1548 (1974).

As noted, *supra*, there is no way in which the state could require Nashville's parent corporation to actually turn over to Nashville the amount of any funds determined by the state to be the proper amount of subsidization. The attempted subsidization thus has no relation to a state attempt to regulate the rates or earnings of Nashville's parent from direct industrial sales. It is purely a subterfuge to prevent Nashville from recovering its costs of rendering its intrastate service, including a just and reasonable rate of return found by the state to be required.

If the reduction in Nashville's revenues under the guise of subsidization of intrastate costs by interstate revenues is unlawful, as we have shown, then *a fortiori* the same results in unconstitutional confiscation of Nashville's property as well as that of its debtholders and the shareholders and debtholders of its parent who were not even parties to the proceeding. In fact, the revenue reduction will undoubtedly result in putting Nashville in default on the outstanding debt financing of its facilities and operations.

This Case Is Not an Isolated Instance Affecting Only Present Parties; It Will Have Continuing Adverse Impact Upon Interstate Commerce

Aside from the errors involving federal constitutional and statutory questions and the unconstitutional confiscation of Nashville's and TNGL's property all as hereinbefore specified, there is an additional reason that this Court should grant the writ as petitioned for herein. The instant proceeding is not an isolated case affecting Nashville only. If the decision stands, it will have a major adverse impact upon the conduct of interstate commerce engaged in by all regulated companies which also conduct intrastate operations either directly or through affiliates. The impact will not only affect gas companies but will also

fall especially upon telephone, railroad, trucking, and electric companies.

The TPSC has already rejected a subsequent rate filing by Nashville on the ground that such filing did not reflect the subsidization approved by the Tennessee Supreme Court (App. Q, *infra*, pp. A141-A145). It is apparent that the TPSC will do the same thing to other regulated intrastate companies subject to its regulation which have interstate operations or affiliates.

The proceedings below have been closely followed by regulated intrastate industries and state regulatory commissions. The Tennessee Court decision has been widely noted. It is obvious that, if the decision of the Tennessee Supreme Court stands, other state commissions will use it as precedent to attempt to accomplish the same purpose, *i.e.*, subsidization of intrastate costs by interstate revenues.

CONCLUSION

WHEREFORE, for the reasons herein shown, this petition for writ of certiorari should be granted.

Respectfully submitted,

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August 29, 1977

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the attached Petition for Certiorari upon all parties required to be served by depositing in the mail, air mail postage prepaid, three (3) copies thereof to counsel for all parties before the Supreme Court of Tennessee, addressed as follows:

Eugene W. Ward, General Counsel
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Dated at Washington, D.C. this 29th day of August, 1977.

Wm. W. Bedwell
Attorney for Nashville Gas
Company

APPENDICES

APPENDIX A

IN THE SUPREME COURT OF TENNESSEE
AT NASHVILLE

FILED
June 2, 1977
Ramsey Leathers
Clerk
Supreme Court

TENNESSEE PUBLIC SERVICE COMMISSION, ET AL.,	)	
Appellants-Defendants,	)	
VS.	)	DAVIDSON EQUITY
NASHVILLE GAS COMPANY,	)	
Appellee-Defendant.	)	

ORDER

Upon application for a STAY of the judgment of this Court pending action by the Supreme Court of the United States on Appellee's Petition for a Writ of Certiorari, said motion being well taken, it is therefore

ORDERED, ADJUDGED AND DECREED that the judgment of this Court of March 21, 1977, reversing the judgment of the Chancery Court of Davidson County and remanding this case to said Court for reference to the Public Service Commission, be STAYED pending disposition by the Supreme Court of the United States. The additional revenues being presently collected as a result of the lower Court's decision shall remain subject to refund, and the Appellee shall further give bond for costs in this cause.

It is further ORDERED, ADJUDGED AND DECREED that if the Supreme Court of the United States denies said Petition or if the Appellee fails to file and perfect such application within the time prescribed by law then the STAY issued herein shall be dissolved upon application of the Appellant, and the decision of this Court carried out.

All other matters are reserved.

/s/ William J. Harbison
JUDGE

APPROVED FOR ENTRY:

ORTALE, KELLEY, HERBERT & CRAWFORD

/s/ John W. Kelley
John W. Kelley
Attorney for Appellee-Plaintiff

CERTIFICATION

I hereby certify that I have this 2nd day of 1977, mailed a true and correct copy of the foregoing to all counsel of record in this cause.

/s/ John W. Kelley
Ortale, Kelley, Herbert & Crawford

APPENDIX B

IN THE SUPREME COURT OF TENNESSEE
AT NASHVILLE

Designated Not for Publication.

TENNESSEE PUBLIC SERVICE COMMISSION, ET AL.,

Appellants-Defendants,

vs.

NASHVILLE GAS COMPANY,

Appellee-Plaintiff.

FILED
May 31, 1977
Ramsey Leathers
Clerk
Supreme Court

Davidson Equity

ORDER ON PETITION FOR REHEARING

A petition for rehearing has been filed on behalf of appellee. After consideration of same, the Court is of the opinion that said petition is not well taken and it is accordingly overruled at the cost of appellee.

Enter this 31 day of May, 1977.

/s/ William J. Harbison
William J. Harbison, Justice

Cooper, C.J., and Fones and Brock, JJ., concur.

Henry, J., not participating.

APPENDIX C

SUPREME COURT, NASHVILLE

FILED
March 31, 1977
Ramsey Leathers
Clerk
Supreme Court

TENNESSEE PUBLIC SERVICE)
COMMISSION, ET AL, Appellant)
)
Vs.) Davidson Equity
)
NASHVILLE GAS COMPANY,) Extension to file
Appellee) brief in support of
) petition to rehear.

ORDER

Upon application of counsel and approval of the Court, the time in this cause for filing brief in support of petition to rehear on behalf of Nashville Gas Company is extended to and including May 2, 1977; and it is so ORDERED.

ENTER, this 31 day of March, 1977.

/s/ William J. Harbison
J U S T I C E

PETITION TO REHEAR FILED TODAY ON BEHALF OF NASHVILLE GAS COMPANY.

/s/ Ramsey Leathers, Clerk.

APPENDIX D

IN THE SUPREME COURT OF TENNESSEE

AT NASHVILLE

TENNESSEE PUBLIC SERVICE)
COMMISSION, ET AL,)
)
Appellants - Defendants,)
)
VS.) DAVIDSON CHANCERY
)
NASHVILLE GAS COMPANY,)
)
Appellee - Plaintiff.)

PETITION FOR REHEARING

/s/ JOHN W. KELLEY, JR.
/s/ WILLIAM W BEDWELL
/s/ LESLIE B. ENOCH, II

Attorneys for Appellee

IN THE SUPREME COURT OF TENNESSEE

AT NASHVILLE

TENNESSEE PUBLIC SERVICE COMMISSION, ET AL.,	)	
Appellants - Defendants,	)	
vs.	)	DAVIDSON CHANCERY
NASHVILLE GAS COMPANY,	)	
Appellee - Plaintiff.	)	

PETITION FOR REHEARING

MAY IT PLEASE THE COURT:

Your Petitioner, the Appellee-Plaintiff ("Appellee") in this cause, being aggrieved by the Court's Opinion filed on March 21, 1977 herein, respectfully requests this Court to grant a rehearing of said Opinion in the belief that certain material facts have been overlooked by the Court. The effect of the Court's Opinion is to cause an invasion of the Appellee's constitutional rights, as will be more fully described herein, as well as the promulgation of violations of other legal principles so well-settled as to be axiomatic. Because of the far reaching impact of the Court's Opinion, Appellee respectfully requests that this Honorable Court grant to it a rehearing for the reasons set forth below:

1. On Page 13 of its Opinion, the Court stated:

> "*We cannot, therefore, at this time know what significance, if any, the Commission will ultimately give to the data which it requested,* but we believe that the Commission was entirely justified in acting within its jurisdiction in taking these into account." (Emphasis Added)

The foregoing language (as well as other language in the Opinion) would indicate that the Court felt it was ruling only on a question as to whether the Commission could require Appellee to furnish information. On the page following the above language, the Court proceeds to remand the cause for the purpose of directing Appellee to produce the information ordered to be supplied by the Commission and for further consideration by the Commission after the information has in fact been supplied.

Appellee respectfully suggests that the above findings have overlooked what the Commission required by its order. The Commission did more than order that such information be furnished. The real crux of the order, and that portion to which objection is raised, is the requirement in the order that the Appellee's rates be reduced by imputing to it the revenues, expenses and investment associated with the sale of gas by its parent company. The Commission specifically ordered:

> "4. That the *Nashville Gas Company is hereby ordered to file* with the Commission a proposed *tariff which will produce additional annual revenue* not to exceed $1,147,044.00 *less the effect of imputing to Nashville Gas Company the revenues, expenses, and investment associated with the sales of gas by its parent,* Tennessee Natural Gas Lines, Inc., to the three industrial customers within Nashville Gas Company's certificated area." (Emphasis Added)

Based upon the above Commission order, the furnishing of the information is somewhat moot. The imputation adjustment is required to take place automatically, which act Appellee contends results in the unlawful confiscation of its property in violation of the Fourteenth Amendment and an infringement upon the commerce clause of the United States Constitution. These constitutional requirements, as prescribed and interpreted by the United States Supreme Court, declare that there must be a segregation of interstate and intrastate costs and revenues and further require that a Company's property cannot be taken without due process of law.

2. On page 2 of the Opinion, the Court stated:

> "This corporation is a 'natural gas company' within the meaning of the Federal Natural Gas Act of 1938, but it is only such because it sells gas to its wholly owned subsidiary, Nashville Gas Company, for resale."

It is respectfully insisted that the Court, in arriving at this conclusion, overlooked the fact that every facet of the entire operation of Tennessee Natural Gas Lines, Inc., is and has been held to be in interstate commerce and all of its sales, including its sales to the direct industrial customers, are fully regulated by the Federal Power Commission. The only control that the Federal Power Commission does not exercise on the direct industrial sales is the price to be charged to those customers. This specific exemption on federal regulation is contained in the Natural Gas Act and is based upon the theory that the industrial customers are in a position to negotiate the price for themselves and do not need the assistance of regulatory control.

If the direct industrial sales are intrastate, as opposed to interstate, business it would have been unnecessary to obtain a certificate from the Federal Power Commission in order for Tennessee Natural Gas Lines to serve DuPont, Ford and Armstrong. Specific approval by the Federal Power Commission is required by Federal law before service is commenced and it would be required again if the Company added additional direct customers or attempted to cease or change the terms of service to such customers. The fact that the State may exercise under the theory of dual regulation the rate to be charged to the direct customer by no means destroys the nature of Tennessee Natural as an interstate carrier. The gas at no time leaves the interstate pipeline of Tennessee Natural and it remains in interstate commerce even if partial jurisdiction to control only rates may be granted to a State Commission.

3. It is correct that the Appellee refused to furnish the data insisted upon by the Commission. This was due to its strong belief that such data was immaterial and irrelevant to the issues before the Commission, which was the setting of the intrastate rate for the Appellee and not its parent company. It is equally

true that the Appellee so refused, as testified to in the record before the Commission and in the Chancery Court, because it would be impossible to correctly compute this information absent a rate hearing before the Federal Power Commission to determine cost allocations between the jurisdictional and non-jurisdictional customers. This is pointed out to the Court to demonstrate the impossible difficulties and quagmire of accounting problems which would come about when two Commissions, with separate jurisdictional rights and obligations, involve themselves in attempting to impute costs and revenues of a company, which are on the one hand determined by the Federal Power Commission, in setting the rates of a different company solely regulated by the State Commission. It also shows a substantial reason why the Courts have consistently prohibited the commingling of interstate and intrastate costs and revenues.

4. The Court has pointed out in its Opinion that dual regulation is clearly constitutionally permitted both by the terms of the Federal statute and by the cases interpreting it. The Appellee fully agrees with the Court's Opinion in recognizing such principle and that the same is unchallengeable. It has been Appellee's position that the State Commission could not exercise regulatory control of these direct sales because of the specific unambiguous language of Tennessee Code Annotated Section 65-403, which exempts from regulation a utility "engaged in interstate commerce for the government or regulation of which jurisdiction is vested in the interstate commerce commission or other federal board or commission." The Tennessee statute does not say that the specific operations of such a utility not regulated by the federal government are exempted; it says that such a utility is exempted, totally.

Appellee requests the Court to reconsider its interpretation of this statutory provision in light of the fact that these direct sales are in interstate commerce and are under the regulatory control of the Federal Power Commission. With the utmost respect for the Opinion of this Court, it is believed that the legislature did specifically exclude from the state regulatory agency the jurisdiction to regulate this matter, even if the Federal government does recognize certain limited rights of the State in the form of dual regulation. Such a restriction on the

state agency is not unusual, since most state regulatory agencies are denied such power on the ground that the rates for such sales are best left to negotiation and competitive factors.

Despite the interpretation of the above Code Section, the important and primary issue in the instant case is not the right of the Commission to regulate these direct sales as to price. In this proceeding or otherwise, the Commission has not attempted to regulate Tennessee Natural Gas Lines, Inc., in any form or fashion. That Company has not at anytime been a party to this litigation before the Commission or the trial Court.

5. The Court's reference to the filing of consolidated reports by parent and subsidiary corporations as being commonplace in modern law and practice is certainly not disputed. The same are frequently required by various statutes and regulatory bodies can and do consider these consolidated returns. However, Appellee respectfully requests the Court to reconsider the conclusions it reached as to the use a regulatory body may place upon such consolidated reports. It is a material fact that, in considering those consolidated corporate returns, regulatory bodies must and do separate costs and revenues of affiliated corporations in ratemaking proceedings so as to avoid one class of customers subsidizing another class and to further avoid the commingling of interstate earnings and costs with intrastate. This is the very error Appellee contends occurred in the case at hand.

The Court's treatment of the subsidiary as an operating division of the parent results in treating both of these companies as if they are in fact the same. The uncontroverted evidence (as noted by the Court) is that these companies were legitimately organized for different reasons and in fact perform different purposes and functions. It is urged that the Court overlooked the material fact that in this instance it would be impossible for these companies to use corporate arrangements or holding companies, as suggested, to manipulate a particular marketing area. The commencement, termination, and all of the terms of service of any customer of Tennessee Natural Gas Lines, Inc., is fully and totally regulated by the Federal Power Commission. In order for that Company to commence, terminate, or change the terms of, service to any customer it

must prove to the satisfaction of that Federal agency that it is in the public interest that it do so. In such proceedings before the Federal Power Commission, the Tennessee Commission and any other party has a right to participate and be heard. Under such circumstances, it is not an area in which corporate arrangements can be manipulated to the detriment of the public.

6. The authorities cited by the Court on pages 9 and 10 of the Opinion fully recognize that regulatory bodies may, for certain purposes, examine intercompany relationships, sales, and transactions between affiliates. In the present case such factor is immaterial since all of the intercompany transactions and sales between Nashville Gas Company and Tennessee Natural Gas Lines, Inc., are fully regulated and totally examined by the Federal Power Commission in the proceedings of which the Tennessee Commission fully participates. To the extent that Nashville Gas Company is affected, such transactions come under the scrutiny of the Tennessee Public Service Commission. This is done in order that the public interest be properly served and to guarantee the propriety of intercompany transactions. But the Appellee maintains that the cases cited by the Court, particularly *Smith vs. Illinois Bell Telephone Co.*, 282 U.S. 133, 51 S. Ct. 65, 75 L. Ed. 255 (1930), and *Colorado Interstate Gas Co. vs. Federal Power Commission*, 324 U.S. 581, 65 S. Ct. 829, 89 L. Ed. 1206 (1945), stand for more than the findings that a regulatory body may examine these intercompany relationships. These cases are landmark decisions of the United States Supreme Court which require the separation of intrastate and interstate costs and revenues in setting rates of return and prohibit the subsidization of one by the other. Even granting to the State Commission the authority to regulate the prices charged for the direct industrial sales, the Commission cannot use those revenues in subsidizing either the intrastate rate of return or the costs of serving a separate class of customers.

The Appellee in its brief cited to this Court the United States Supreme Court case of *Smith vs. Illinois Bell Telephone Co.*, *supra*, for the proposition that intrastate and interstate revenues and costs must be segregated in establishing the rates of the intrastate company. This Court has observed in its Opinion on pages 9 and 10 that the Supreme Court had "expressly held that

the relationship between the subsidiary, its parent and its sister corporation demanded 'close scrutiny' even though it recognized that separate corporate structures and operations should be observed." This Court further interpreted that case as requiring or permitting rate makers to consider the net profits of the interstate company in setting rates of the intrastate company.

Appellee respectfully submits that the interpretation of *Smith vs. Illinois Bell Telephone Co., supra,* is out of context and erroneous. First, the "close scrutiny" language cited by this Court as part of the holding in *Smith, supra,* is actually *obiter dictum* arising from a discussion of an unrelated subject. Because of the relationship of American Telephone & Telegraph with Illinois Bell the City of Chicago had attacked the standing of Illinois Bell as the real party plaintiff in the case. *Id.,* at 282 U.S. 143. The Court rejected this contention, observing that the regulatory Commission's order had been directed at the Illinois Company, and that Illinois Bell had been treated as a corporation for the purposes of compelling it to establish prescribed rates. The Court commented that simply because the relationship of the American Company and the Illinois Company "may demand close scrutiny, in dealing with certain questions which bear upon the validity of the rate order . . . .", Illinois Bell was nonetheless the real party in interest and had standing to sue. Appellee submits that the Court did not hold, therefore, that "close scrutiny" was required in cases in which a parent has interstate revenue which a regulatory body seeks to impute to a subsidiaries' intrastate based rates.

The "certain questions" which the Supreme Court scrutinized related peculiarly to the facts of that case and did not contradict the primary holding of the case as to the segregation of interstate and intrastate business. In setting rates for Illinois Bell, a determination of the fair rate base necessarily involved the division of expenses and revenues arising from interstate telephone calls. The Illinois Company owned and operated all property in the City of Chicago used in interstate calls and connected with American Telephone equipment at the city limits. As a matter of practical convenience, all of the expenses of the Chicago equipment were attributed by Illinois Bell to its intrastate service. The Supreme Court required that a

division be made and held that unless the apportionment was in fact made, that the intrastate service would bear an "undue burden," *Smith vs. Illinois Bell Telephone Co.,* 282 U.S. 149, 150.

Thus the term "close scrutiny" alluded to by the Court referred to a refinement in the division between interstate and intrastate matters and is not authority to permit a commingling of the two spheres as sought by the Tennessee Public Service Commission. The Court found that the "proper regulation of rates can be had only by maintaining the limits of State and Federal jurisdiction" and required further findings of fact to more clearly delineate interstate and intrastate business. *Smith vs. Illinois Bell Telephone Co.,* 282 U.S. 149.

The second area of "close scrutiny" in *Smith,* involved the purchase of equipment from Western Electric, a sister company, by Illinois Bell. The State Commission agreed that the prices paid for first the rental and later the purchase of the equipment was too high. The State Commission, it should be noted, regulated the amount Illinois Bell could pay, and in 1924-27 the contract amount exceeded the amount Illinois Bell was allowed. Because of the special relationship between Western Electric and Illinois Bell, it was contended that the prices charged were exorbitant. It should further be pointed out that Illinois Bell rather than Western Electric was the subject of the regulation but in determining whether the price was fair and the rate base therefore appropriate, it was necessary to look at the pricing from Western Electric's point of view.

The Court had before it proof that Western's average profit over a fourteen year period was seven to ten percent. That finding was insufficient, because it included sales to other companies. The Court proceeded to examine evidence in the record relative to this issue. The effort was to allocate operating expenses of the intrastate business of Illinois Bell on a fair basis and not to assign revenues of Western Electric to the sister company. Nowhere in the Opinion is there authority for capturing interstate revenues for use in setting intrastate rates. On the contrary, the Court's examination of these questions did "not alter the fact that the Illinois business is to be treated as a segregated enterprise." *Smith vs. Illinois Bell Telephone Co.,*

282 U.S. at 151.

The importance of the foregoing analysis of *Smith* is to show that this case is far from being authority in favor of imputation and is, instead, authority for the proposition that the same is unlawful. The separation of these properties, revenues and expenses was important, the Court held, "not simply as a theoretical allocation," but as a principle "essential to the appropriate recognition of the competent government authority in each field of regulation." The Commission, the Court specifically held, "would have no authority to impose intrastate rates, if as such they would be confiscatory, on the theory that the interstate revenue . . . could be increased to make good the loss." *Id.*, at p. 148, 149. To like effect are the numerous cases cited by Appellee in its earlier brief to this Court.

This forbidden technique is precisely that attempted by the Tennessee Public Service Commission in the instant case. The intrastate return determined by the Commission to be fair and non-confiscatory is to be supplied by interstate revenues. As previously indicated, the Commission has not attempted to regulate Tennessee Natural and this is not the issue in dispute. The Commission has imputed these interstate revenues of Tennessee Natural in setting the intrastate rate of Nashville Gas. It is respectfully submitted that this is contrary to the findings by the United States Supreme Court in the *Smith* case, *supra*, and the consistent holdings in the various other cases cited by Appellee in its brief.

Throughout these proceedings and the Court reviews involved, the Appellant Commission has not cited, and it cannot cite, a single instance where approval has been given to subsidize intrastate rates by interstate revenues nor to have one class of consumers subsidize another class of consumers even where both classes are supplied by the same Company. Appellee contends that it is axiomatic and well settled regulatory law that such is not within the power or jurisdiction of a regulatory body. Such action, when analyzed, results in confiscation of the property of Nashville Gas Company in violation of the Fourteenth Amendment of the Constitution of the United States. Further, it is repugnant to and an infringement of the interstate commerce clause of the Constitution as interpreted

by the Supreme Court of the United States.

Even if Tennessee Natural and Nashville Gas were one company totally subject to the jurisdiction of the Tennessee Commission, the "imputation" sought to be applied by the Commission would be unlawful because it would result in having one class of consumers subsidize other classes of consumers as prohibited by Tennessee Code Annotated Section 65-521, which provides as follows:

> "Unjust rate, fare, schedule or classification prohibited. – No public utility shall:
>
> Make, impose, or exact any unreasonable, *unjustly discriminatory or unduly preferential* individual or joint rate, or special rate, toll, fare, charge, or schedule for any product, or service supplied or rendered by it within this state.
>
> Adopt or impose any unjust or unreasonable classification in the making or as the basis of any rate, toll, charge, fare, or schedule for any product or service rendered by it within this state." (Emphasis Added)

The numerous cases cited by Appellee in its Brief unanimously hold that, as between classes of customers, the rates must be fixed on the basis of cost of serving the individual classes of customers and any subsidization of the cost of serving one class by another results in discriminatory and unduly preferential rates.

CONCLUSION

It is respectfully submitted that, for the reasons set forth above, rehearing should be granted by this Honorable Court and this Court should reconsider its Opinion in this cause. Appellee will file a supportive brief of the law and authorities as soon as reasonably possible. In filing this Petition to Rehear, Appellee is fully respectful of this Court and the Opinion of this Court but believes that the magnitude of the impact of this order should be reconsidered and re-examined in light of the above showings.

Respectfully submitted,

ORTALE, KELLEY, HERBERT & CRAWFORD

By: /s/ John W. Kelley

BEDWELL & RUDOLPH

By: /s/ William W. Bedwell

NASHVILLE GAS COMPANY

By: /s/ Leslie B. Enoch, II

ATTORNEYS FOR APPELLEE,
NASHVILLE GAS COMPANY

CERTIFICATE OF SERVICE

The undersigned does hereby certify that a copy of this Petition to Rehear has been furnished to all adverse counsel of record before being presented to this Court on this the 31st day of March, 1977.

/s/ John W. Kelley
Attorney

APPENDIX E

FOR PUBLICATION

IN THE SUPREME COURT OF TENNESSEE

AT NASHVILLE

FILED
March 21, 1977
Ramsey Leathers
Clerk
Supreme Court

TENNESSEE PUBLIC SERVICE COMMISSION, ET AL.,	)
Appellants-Defendants,	)
vs.	) Davidson Equity
	) Hon. Ben H. Cantrell, Chancellor
NASHVILLE GAS COMPANY,	)
Appellee-Plaintiff.	)

For Appellants-Defendants:

Eugene W. Ward
T.E. Midyett, Jr.
Larry Woods
Jinx S. Thomas
Nashville, Tennessee

For Appellee-Plaintiff:

John W. Kelley, Jr.
Leslie B. Enoch, II
Nashville, Tennessee

William W. Bedwell
Washington, D.C.

O P I N I O N

REVERSED AND REMANDED

HARBISON, J.

Appellee, Nashville Gas Company, is a gas distributing company, serving Metropolitan Nashville and portions of several adjacent counties in Middle Tennessee. It is a Tennessee corporation, engaged solely in intrastate commerce, and is a public utility subject to the jurisdiction of and regulation by the Tennessee Public Service Commission.

All of the stock of appellee is owned by another Tennessee corporation, Tennessee Natural Gas Lines, Inc., which is publicly held. This corporation is a "natural gas company" within the meaning of the federal Natural Gas Act of 1938,[1] but it is such only because it sells natural gas to its wholly-owned subsidiary, Nashville Gas Company, for resale. Otherwise, it is a domestic corporation operating wholly within the boundaries of the state. Other than its subsidiary, it has three other customers to which it makes direct sales of natural gas, all of these being large industries situated in Davidson County and being within the area authorized to be served by the subsidiary, Nashville Gas Company, under its certificate of convenience and necessity.[2]

Tennessee Natural Gas Lines, Inc., does not have a certificate from the state Commission. Since it is a "natural gas company" within the meaning of the federal statute, its operations are regulated by the Federal Power Commission, to the extent of the jurisdiction of that Commission. It is undisputed, however, that the Federal Power Commission does not fix the prices which Tennessee Natural Gas Lines, Inc., charges to its direct industrial customers in the Nashville area, nor does it have jurisdiction to do so under present statutory provisions.

---

[1] 15 U.S.C.A. §717.

[2] The subsidiary was apparently not franchised by the City of Nashville to sell outside the city limits, and it did not receive a franchise from local government to serve all of Davidson County until the advent of Metropolitan Government in 1963. Nevertheless it was certificated by the Commission to serve Nashville and its environs in the 1930s or before, and it made sales outside the Nashville city limits under that certificate long before 1963. Its franchised territory under local government and its certificated area by the Commission are not and have never been identical.

On January 16, 1975, appellee, Nashville Gas Company, made application to the Tennessee Public Service Commission for an emergency rate increase, seeking additional revenues in order to enable it to meet the requirements of a maturing bond issue. Temporary rate increases were authorized and put into effect, under bond, on March 13, 1975. On April 14, 1975 appellee filed with the Commission an application for a general permanent rate increase, and the two matters were consolidated for hearing and disposition.

Extensive hearings were held and a voluminous record compiled before the Commission in September and October 1975. On October 14, the Commission entered an order finding that Nashville Gas Company was entitled to a rate structure which would yield 13.5% return on common equity and 12.14% return on its rate base. In order to accomplish this return, the Commission found that appellee required additional annual gross revenues of \$3,056,132.00. The emergency rate increases under bond were found to produce \$1,909,088.00 of this amount, and these increases were made permanent. The Commission found that an additional \$1,147,044.00 in gross revenues, over the bonded revenues, were required It authorized tariffs to produce this additional revenue subject, however, to an offset or reduction by the revenues received by the parent corporation, Tennessee Natural Gas Lines, Inc., from its direct industrial sales within the Nashville area. The Commission found that the appellee had declined to furnish it with the necessary data to compute accurately the amount of this offset or reduction, referred to in the record as an "imputation adjustment". It directed appellee immediately to file with the Commission additional data which the Commission felt necessary in order for it to determine the effect of the operations of the parent upon the authorized rate structure of the subsidiary. One member of the Commission dissented as to this portion of the order, stating that he regarded the operations of the parent corporation as entirely separate and distinct from those of the subsidiary; therefore, he considered irrelevant and illegal the additional information ordered by the majority.

Continuing its refusal to furnish the requested data, appellee filed a petition for certiorari to the Chancery Court pursuant to T.C.A. § 65-220,* and also filed an original complaint in that court, alleging that the rate structure authorized by the Commission was confiscatory.

Both before the Commission and in the Chancery Court there were numerous contested issues, involving many factors and considerations which go into the complex process of utility rate making. The Chancellor resolved most of the disputed issues in favor of the Commission and generally approved its October 14, 1975 order, with two exceptions. The two issues which he resolved in favor of appellee form the basis of the present appeal to this Court by the Commission.

The Chancellor held that the Commission was in error in taking into consideration the operations and revenues of the parent corporation, Tennessee Natural Gas Lines, Inc., and in directing the filing of additional data concerning its industrial sales in Davidson County, holding that these were an improper and irrelevant consideration in fixing reasonable rates for the subsidiary. He also resolved in favor of appellee a disputed issue concerning the reasonableness of expenses and fees incurred in the present rate proceedings. We will consider these two issues separately.[3]

---

*Neither party has cited the Uniform Administrative Procedures Act, T.C.A. §§ 4-507 et seq. However, its application would not affect the issues presented to us.

[3]In support of its assignments of error, appellant Commission has attached as "Exhibits" to its brief a number of documents not introduced in evidence in the Commission hearings or before the Chancellor. This is improper practice, and we sustain appellee's Motion to Strike these documents and the references thereto in appellant's brief. No consideration has been given to them by the Court.

I. The Parent-Subsidiary Issue

It is clear from the record in this case that the prices which the parent corporation, Tennessee Natural Gas Lines, Inc., charges its subsidiary for natural gas are regulated by the Federal Power Commission. Also regulated by that Commission are the volumes and priorities of natural gas sold by the parent to its three large industrial customers in the Nashville area. The prices at which such gas is sold to these industries is not, however, regulated by the Federal Power Commission nor, under the settled interpretation of the Natural Gas Act, are those prices subject to regulation by that Commission. *See Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 81 S. Ct. 435, 5 L. Ed. 2d 377 (1961); *Cities Service Gas Co. v. U.S.*, 500 F.2d 448 (Ct. Claims 1974).

It is also well settled that the Natural Gas Act was not designed to remove from the states substantial regulation of the natural gas industry, but rather it was designed to provide federal regulation in certain areas which were not subject to state jurisdiction under the interstate commerce clause of the United States Constitution. Dual regulation is clearly contemplated both by the terms of the federal statute and by the cases interpreting it. *Memphis Natural Gas Co. v. McCanless,* 183 Tenn. 635, 194 S.W.2d 476 (1946), *appeal dismissed* 329 U.S. 670, 67 S.Ct. 99, 91 L. Ed. 591 (1946).

In the case of *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana,* 332 U.S. 507, 68 S. Ct. 190, 92 L. Ed. 128 (1947), the United States Supreme Court expressly held that direct sales to industrial customers by an interstate pipe line carrier are subject to regulation by state utility commissions, even though such sales are a part of interstate commerce. *See also Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission,* 341 U.S. 329, 71 S. Ct. 777, 95 L. Ed. 993 (1951), where an interstate pipe line was required to obtain a certificate of convenience and necessity from a state commission before making direct industrial sales to natural gas customers. There the Court said:

> "... the sale and distribution of gas to local customers made by one engaged in interstate

commerce is 'essentially local' in aspect and is subject to state regulation without infringement of the Commerce Clause of the Federal Constitution, article 1, § 8, cl. 3. In the absence of federal regulation, state regulation is required in the public interest." 341 U.S. at 333.

Since, in the present case, the parent corporation, Tennessee Natural Gas Lines, Inc., is regulated by the Federal Power Commission as to volumes and priorities, it would not be appropriate for the local Commission to undertake such regulation. Inasmuch as the prices charged by the parent corporation to its customers are not regulated, however, we think that it is beyond question that the Tennessee Public Service Commission has jurisdiction and authority to regulate those prices directly, if it should see fit to do so.

We have previously pointed out that the parent corporation is in "interstate commerce" solely and exclusively because of the language of the federal Natural Gas Act, 15 U.S.C.A. § 717, which places under the Federal Power Commission sales in interstate commerce for resale. Were it not for the sales made by the parent directly to its subsidiary for resale, the entire system of the parent and the subsidiary would be wholly intrastate, and would be subject to regulation in its entirety by the Tennessee Public Service Commission. The parent corporation does not operate across state lines, but its pipeline taps onto an interstate pipeline in Cheatham County, Tennessee, and brings natural gas into Davidson County, where it is sold to the subsidiary and to the three industrial customers.

Tennessee Natural Gas Lines, Inc. has no operating employees. Nashville Gas Company has some three hundred and forty-two operating employees. These perform various tasks for the parent as well as the subsidiary, and the parent reimburses the subsidiary for their services. The two corporations have common officers and directors, some of the officers being wholly paid by the subsidiary and some of them being paid by the parent. The parent acquired all of the stock of the subsidiary in 1945, and has held it continuously since that time.

The dissenting member of the Public Service Commission felt that it was improper for the Commission to consider any of the operations and sales of the parent, because of the separate corporate structure and because the parent is engaged in interstate commerce, subject to federal regulation. He also felt that it was improper to "pierce the corporate veil" because there was no evidence of fraud, misconduct or impropriety in the management and operation of the two companies.

We are in agreement with the latter statement of the Commissioner, and because of certain statements and comments made in the briefs and in the record, we feel constrained to state that we find no evidence whatever of any misconduct, illegality or impropriety in any of the management decisions and transactions which are reflected in this record. The decisions by the management of the two companies to have the direct sales made to industrial customers by the parent, rather than the subsidiary, were based upon legitimate financial and corporate concerns at the time, probably including the fact that the sales were not subject to federal regulation and had not in fact been regulated locally. There were many other considerations which entered into the decisions, however, all of which were justified from a management and financial standpoint.

Having said this, we are, on the other hand, equally convinced that a regulatory body, such as the Public Service Commission, is not bound in all instances to observe corporate charters and the form of corporate structure or stock ownership in regulating a public utility, and in fixing fair and reasonable rates for its operations. The filing of consolidated reports by parent and subsidiary corporations, both for tax purposes and regulatory purposes, is so commonplace as to be completely familiar in modern law and practice. Considerations of "piercing the veil", which are involved in cases involving tort, misconduct or fraud, are largely irrelevant in the regulatory and revenue fields. In order for taxing authorities to obtain accurate information as to revenues and expenses, the filing of consolidated tax returns by affiliated corporations is frequently required, and ratemaking and regulatory bodies frequently can and do

consider entire operating systems of utility companies in determining, from the standpoint both of the regulated carrier and the consuming public, fair and reasonable rates of return.

In some of the federal cases most relied upon by appellee in its brief, the courts have considered parent and subsidiary corporations as a group or as an operating system, and have considered for rate-making purposes many aspects of inter-company relationships, including sales between affiliated companies, expenses charged and the like. Thus, in the case of *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 51 S. Ct. 65, 75 L. Ed. 255 (1930), relied upon by appellee for the proposition that intrastate and interstate revenues, property and expenses must be allocated in fixing utility rates, the Supreme Court of the United States set aside and reversed a district court order which had found confiscatory certain rates set by an Illinois regulatory commission. The Court remanded the case for further proof and specific findings as to the reasonableness of charges made to the regulated intrastate company by its interstate parent and an interstate affiliate, the parent owning 99% of the stock of both the regulated company and the affiliated corporation, Western Electric Company.

In that case, the Court expressly held that the relationship between the subsidiary, its parent and its sister corporation demanded "close scrutiny" even though it recognized that separate corporate structures and operations should be observed. In that case the Court referred to Western Electric Company as "virtually the manufacturing department" of the entire system, and its net profits were specifically required to be taken into consideration in connection with the rates of the intrastate company, Illinois Bell Telephone Company, then under consideration.

Similarly, in *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U.S. 581, 65 S. Ct. 829, 89 L. Ed. 1206 (1945), the Federal Power Commission treated two separate companies, subsidiaries of larger oil companies, as having been "operated as a single enterprise." 324 U.S. at 588. In that case transactions by which leaseholds had been transferred to a subsidiary were ignored, and certain interstate

wholesale rates were required to be reduced because of an excess of revenues over cost. The Court said:

> "The fact that the negotiations between Southwestern and Standard were at arm s length has no bearing on the present problem. The end result is that property has been transferred at a write-up from one of Southwestern's pockets to another. The impact on consumers of utility service of write-ups and inflation of capital assets through inter-company transactions or otherwise is obvious. The prevalence of the practice in the holding company field gave rise to an insistent demand for federal regulation." 324 U.S. at 608.

See also Cities Service Gas Co. v. Federal Power Commission, 424 F.2d 411 (10th Cir. 1969), *cert. dismissed* 400 U.S. 801, 91 S. Ct. 9, 27 L. Ed. 2d 33 (1970); *Cities Services Gas Co. v. Federal Power Commission*, 155 F.2d 694 (10th Cir. 1946), *cert. den.* 329 U.S. 773, 67 S. Ct. 191, 91 L. Ed. 664 (1946).

Even though the direct sales of the parent corporation in the present case are a part of interstate commerce, by reason of the parent's being a natural gas company subject to the federal Natural Gas Act, these sales are essentially local in nature and have been expressly held to be subject to a state gross receipts tax. *Tennessee Natural Gas Lines, Inc. v. Atkins*, 199 Tenn. 468, 287 S.W.2d 67 (1956).

The appellee insists that the Tennessee Public Service Commission has no jurisdiction over the direct sales of its parent to the industrial customers because in 1969 the Commission dismissed proceedings which it had initiated contemplating possible total regulation of the parent. We find the contention of the appellee to be unpersuasive. Whether or not the Commission could or could not regulate all phases of the operations of the parent corporation, we think it unquestionable from the federal cases construing the Natural Gas Act that the Tennessee Commission does have authority to regulate the prices charged in these direct industrial sales. We do not regard the 1969 proceedings as having any

significance with respect to the present rate case.

Appellee contends further, however, that the Tennessee statutes themselves prohibit the Commission from regulating interstate commerce, citing T.C.A. § 65 403. This statute exempts from state regulation public utilities "engaged in interstate commerce for the government or regulation of which jurisdiction is vested in the interstate commerce commission or other federal board or commission."

We have already noted that the Federal Power Commission only partially regulates the operations of the parent corporation, and certainly both the state statutes and the federal Natural Gas Act contemplate a complete system of dual regulation of the natural gas industry.

Finally it is insisted on behalf of appellee that the industrial sales were contracted by the parent, and the pipelines and facilities built at the expense of the parent, wholly separate from the subsidiary, and at a time when the subsidiary could not financially have afforded the capital outlay necessary to enable it to make these sales.

There is no question but that the two companies have had in the past separate historical development, and we have already stated that we find no illegality whatever in the management decisions which resulted in the present situation. It must be remembered, however, that Nashville Gas Company is wholly owned by Tennessee Natural Gas Lines, Inc. Throughout the record and throughout its brief on appeal, appellee stresses the frequent subsidization of the subsidiary by the parent over the years, and it seems to us that the subsidiary in actuality is nothing more than an operating division of the parent. Management decisions, for legitimate reasons, may have placed the industrial sales and the facilities requisite therefor in the parent company, but this does not prevent a public regulatory body from considering them as part of one operating system and taking them into account in determining the proper rate base and rate structure of the subsidiary. Otherwise, it would be a simple matter, through the device of holding companies, spinoffs, or other corporate arrangements, to place the cream

of a utility market in the hands of a parent or an affiliate, and to strip the marketing area of a regulated subsidiary of its most profitable customers. *See Industrial Gas Co. v. Public Utilities Comm'n of Ohio,* 135 Ohio 408, 21 N.E.2d 166 (1939).

Throughout the lengthy involved hearings reflected in the record in this case, much information concerning the parent corporation and its sales was introduced into the record. The Commission felt, however, that it did not have enough information about present contracts, depreciation schedules, historical costs and the like to determine the extent to which the industrial sales of the parent should be taken into account in fixing appropriate rates for the subsidiary. We cannot, therefore, at this time know what significance, if any, the Commission will ultimately give to the data which it requested, but we believe that the Commission was entirely justified and acting within its jurisdiction in taking these into account. From such information as is already contained in the record, it appears that the parent corporation receives substantial profits from these sales, reflecting a net return on the equity capital of the consolidated enterprise not greatly less than that which the Commission found necessary and proper for the subsidiary alone.[4]

The Chancellor hold that the Commission had violated a fundamental principle of rate making in failing to separate interstate from intrastate operations. He stated that even if the parent and subsidiary were merged into one corporation, such allocation would still have to be made. This, however, overlooks the fact that if the two corporations were merged, there would be no interstate commerce involved at all, because there would be no "sales for resale" and the entire system would be an intrastate distributing company.

[4]The general rate increase proposed in this case did not involve residential customers. Its effect, therefore, will be to raise the rates charged to industrial and commercial customers of the subsidiary, and it therefore seems particularly relevant that consideration should be given to the revenues received by the parent from its industrial sales in the same marketing area.

While the principle referred to by the Chancellor is a well-recognized and fundamental one, it is usually applied in cases where a regulatory body has only partial jurisdiction over a utility, or where a utility company has separate non-utility operations, not subject to regulation. Such a situation is not presented in the present case, where the subsidiary is entirely subject to regulation by the Tennessee Public Service Commission, and the direct sales of its parent are also subject to such regulation.

The decree of the Chancellor in this case is reversed, insofar as it dealt with the parent-subsidiary relationship, and this cause will be remanded to the Chancery Court, with directions to refer it to the Commission for the production by the Nashville Gas Company of the information ordered to be supplied by the Commission, and further consideration by the Commission after that information has been supplied.

II. Rate Case Expenses

The Commission authorized the applicant Nashville Gas Company to include in its cost of services $100,000.00 for expenses incurred in counsel fees, consulting fees and other charges in the preparation and presentation of this case. By an exhibit, filed several days after the close of the hearings before the Commission, appellee claimed $203,420.00 in expenses, more than double the amount allowed by the Commission. In its complaint in the chancery court, appellee alleged that it was never given a hearing on its late-filed exhibit, and that the action of the Commission was unreasonable. The Chancellor found no evidence contrary to that contained in the exhibit and allowed the entire amount of claimed expenses, to be amortized over a three-year period.

Since we have ordered a remand of this case to the Commission, we think that the item of expenses should also be reconsidered by the Commission, with both the appellee and the commission staff having an opportunity to present such additional evidence as they desire. We are not prepared to accept some of the items contained in the late-filed exhibit, nor do we believe that the Commission was obligated to do so, at least without some explanation or supporting testimony. We think a further hearing on this entire issue would be aporopriate.

The decree of the Chancery Court is reversed as to the two issues involved on this appeal, and the cause is remanded to that Court for reference to the Commission as above indicated. Costs incident to the appeal to this Court will be taxed to appellee. All other costs will be fixed by the Chancellor.

/s/ William J. Harbison, Justice

Cooper, C.J., and Fones and
Brock, JJ., concur.

Henry, J., not participating.

APPENDIX F

SUPREME COURT, NASHVILLE

FILED
October 7, 1977
Ramsey Leathers
Clerk
Supreme Court

TENNESSEE PUBLIC SERVICE COMMISSION, ET AL, Appellant-Defendants	)	
Vs.	)	Davidson Equity
NASHVILLE GAS COMPANY, Appellee-Plaintiff	)	Extension.

ORDER

Upon application of counsel and approval of the Court, the time in this cause for filing reply brief is extended to and including November 15, 1976, and it is so ordered.

It is further ordered that the case will be scheduled for oral argument at the December, 1976, session.

/s/William J. Harbison
JUSTICE

APPENDIX G

IN THE CHANCERY COURT OF DAVIDSON COUNTY, TENNESSEE
AT NASHVILLE, PART ONE

NASHVILLE GAS COMPANY	)	
Vs.	)	No. A-6395
TENNESSEE PUBLIC SERVICE COMMISSION, ET AL	)	

ORDER

This matter is before the Court upon the application of the Defendant, Tennessee Public Service Commission, for a 60-day extension of time for the presentation of the bill of exceptions in the above captioned matter to the Court for authentication. For good cause shown;

IT IS THEREFORE ORDERED

1. A 60-day extension of time within which to file the bill of exceptions in the above captioned matter is hereby granted.

/s/ Ben H. Cantrell
CHANCELLOR

Entered this 4th day of May, 1976.

IN THE CHANCERY COURT OF DAVIDSON COUNTY,
TENNESSEE
AT NASHVILLE, PART ONE

NASHVILLE GAS COMPANY	)	
	)	
Vs.	)	No. A-6395
	)	
TENNESSEE PUBLIC SERVICE COMMISSION, ET AL	)	

FINAL DECREE

This cause came on to be heard on February 26, 1976, before the Honorable Ben H. Cantrell, Chancellor, holding Part One of the Chancery Court of Davidson County, Tennessee, upon the entire record, including the pleadings of the parties and intervenors, the record before the Commission, affidavits filed in this Court, testimony of the witnesses, briefs and argument of counsel. Whereupon said cause was taken under advisement and upon full consideration the Court has issued its Memorandum Opinion dated March 24, 1976, which said Memorandum Opinion is hereby ordered filed and made a part of the record in this cause, and which Memorandum Opinion is incorporated in this decree by reference as fully as if each and every item therein were set forth herein verbatim.

IT IS, ACCORDINGLY, ORDERED, ADJUDGED AND DECREED by the Court that:

(1) That the action of the Tennessee Public Service Commission in seeking by its order to impute the earnings of Tennessee Natural Gas Lines, Inc., in its interstate operations to Nashville Gas Company involved solely in intrastate operation was error and beyond the scope of its authority and its actions in doing the same is hereby reversed.

(2) That there is no error contained in the Commission's weather normalization method.

(3) That an annual sales volume of 21,212,087 Mcf is reasonable based upon 1975 actual sales of 20,850,384, has a rational basis, and should be used by the Commission in setting rates.

(4) That the volume of gas to be sold from the LNG tank addresses itself to the sound discretion of the company management.

(5) That the Commission's determination as to the proper depreciation rate has a rational basis and should not be disturbed.

(6) That the Commission's action in reducing regulatory Commission expense and the cost of service is arbitrary and not based on the evidence and that the full amount of $203,420.00 amortized over a three year period should be included as the regulatory Commission expense in the cost of the company's service.

(7) That the Defendant(s) are hereby granted an appeal to the next term of the Supreme Court of Tennessee sitting at Nashville and are granted thirty days from the date of the entry of this Decree within which to perfect their appeal(s).

(8) That the Commission's Order be, and the same is hereby, modified to allow the company to put into effect rates which will produce a return of 13.5 percent to equity with the adjustments allowed by this Court as set forth above and in the Memorandum Opinion incorporated by reference.

(9) That the rates authorized herein shall be allowed to become effective upon Commission approval, but no later than April 6, 1976, and shall be subject to refund pending a decision of the Supreme Court of Tennessee in the appellate proceeding allowed in 7 above.

(10) That the Company and Commission will undertake all steps necessary to carry out the Commission Order as modified and amended by this Decree and the findings set forth in the Court's Memorandum Opinion.

(11) That the costs of this cause are hereby taxed to the Tennessee Public Service Commission for which amount execution may issue, if necessary.

Entered this 5th day of April, 1976.

BEN H. CANTRELL, CHANCELLOR

APPROVED FOR ENTRY:

BEDWELL & RUDOLPH

By:

Attorneys for Plaintiff
Nashville Gas Company

ORTALE, KELLEY, HERBERT & CRAWFORD

By:

Attorneys for Plaintiff
Nashville Gas Company

Leslie B. Enoch, Attorney for
Plaintiff, Nashville Gas Company

TENNESSEE PUBLIC SERVICE COMMISSION

By: /s/ Eugene W. Ward

Eugene W. Ward, Attorney for
Tennessee Public Service Commission

By: /s/ T.E. Midyett, Jr.

T.E. Midyett, Jr., Attorney for
Tennessee Public Service Commission

Larry D. Woods, Attorney for
Intervenor

NASHVILLE GAS COMPANY	)	
	)	IN THE CHANCERY
VS. NO. A-6395	)	COURT,
	)	PART ONE,
TENNESSEE PUB LIC SERVICE	)	
COMMISSION, ET AL	)	AT NASHVILLE.
	)	

MEMORANDUM

This case is in court on the original bill of complaint and petition for certiorari filed by the plaintiff, Nashville Gas Company. (Hereafter referred to as "Nashville Gas"). The complaint seeks a review of the action of the defendant, Public Service Commission (hereinafter "The Commission") which was expressed in the Order of the Commission filed on October 14, 1975. The Commission in a split decision found a just and reasonable rate of return on rate base of 12.14 percent, and 13.5% on equity. According to the Commission's Order this would require additional revenues in the amount of \$3,560,132.00 The company had previously been allowed to collect under bond additional gross revenues of \$1,909,088.00. The commission ordered the remaining \$1,147,044.00 to be reduced by the return to the parent company, Tennessee Natural Gas Lines, Inc., (hereafter "Tennessee Natural") on sales to three industrial customers within Nashville Gas Company's certificated area.

In the complaint the plaintiff alleges that the Commission erred in its treatment of six different aspects of the case. They are as follows:

1. The parent-subsidiary relationship.
2. Volumes of gas to be sold.
3. Depreciation treatment.

4. Regulatory Commission expense.
5. Rate of return.
6. Metro franchise fee.

With respect to item 6 above the plaintiff does not seek the action of this Court in determining the proper rate of the fee or to which customers the fee should be billed. Therefore, the Court will not deal with this item. Neither does the plaintiff attack the 13.5% return to equity. It does, however, allege that it cannot earn that amount under the Commission's Order.

The Commission and certain intervenors have filed their answers joining issue on the allegations in the complaint, and after further hearing in this Court the case is now ready for disposition. The following shall constiturecomplaint, and after further hearing in this Court the case is now ready for disposition. The following shall constitute the findings of fact and conclusions of law of the Court:

I

The predecessor of the plaintiff company was the Nashville Gas & Heating Company which originally manufactured and distributed coke gas in the corporate limits of the City of Nashville. Neither Nashville Gas nor the city had a source of natural gas until the Nashville Gas Company was purchased by Tennessee Natural in 1945. The franchise given to Nashville Gas by the City Council of the City of Nashville reserved the right for the Mayor and City Council under certain conditions to grant a license to other companies to engage in the same or similar business within the corporate limits of the city.

Nashville Gas was purchsed by Tennessee Natural in 1945 and since that time has been a wholly owned subsidiary of Tenessee Natural.

Tennessee Natural in a Natural Gas Company within the meaning of the Natural Gas Act and subject to the jurisdication of the Federal Power Commission. It owns and operates a pipe line from the Tennessee Gas Transmission Company's line in Cheatham County and connects to the

facilities of Nashville Gas through the city gate located in Bordeaux. In addition to supplying its subsidiary, Nashville Gas, it serves directly three large industrial customers in Davidson County, Tennessee. Service was extended to the DuPont Planin Old Hickory in 1951, to the FordGlass Plant in 1956 and Gates Rubber Company in 1959. (Gates Rubber Co., is now Armstrong Rubber Co.)

The Commission has recognized since 1931 that Nashville Gas and its predecessors have had authority to sell natural gas "at Nashville and vicinity" (November 10, 1931, Order); "Nashville, adjacent and contiguous areas' (Opinion and Order of October 17, 1945); "the City of Nashville and vicinity" (Order of July 8, 1946).

In 1963 with the advent of the Metropolitan Government for Nashville and Davidson County, Tennessee, the certificated area for Nashville Gas was extended to include all of Davidson County.

When the gas line was extended by Tennessee Natural to the DuPont Plant in Old Hickory, Nashville Gas befan serving customers in the areas of Madison, Amqui, Rayon City, Old Hickory, and Dupontonia. All of these localities were outside of the city limits of Nashville. Nashville Gas now serves customers outside of the corporate limits of Nashville and Davidson County, Tennessee.

In accordance with the natural Gas Act Tennessee Natural has the authority to sell natural gas to direct industrial customers subject to FPC approval. The sales are not to be subject to the FPC approval as to price. The sales to Ford, DuPont and Armstrong, fall into this category. Therefore, the price to gas sold to these large industrial customers is not now regulated by the Commission nor by the Federal Power Commission.

In 1969 the Commission issued an Order to Tennessee Natural to appear and show cause why it should not be declared a public utility and subject to the rules and regulations o the Commission. As a result of those proceedings the Commission concluded that Tennessee Natural was a Natural Gas Company as defined in the Natural Gas Act

in 1938 and was engaged in interstate commerce, regulated by the FPC, and that the Commission did not have jurisdiction to regulate Tennessee Natural.

The cost of laying the line to the DuPont Plant in 1958 was $775,000.00. The cost to Tennessee Natural to serve Ford in 1956 was $540,000.00. The capital expenditures necessary to serve the Gates Rubber Plant were $56,000.00. At the time this service was extended by Tennessee Natural to each of these three industrial consumers, Nashville Gas Company could not have extended its service lines to serve these customers because of the burden it would have placed on its limited capital structure.

The Commission, during the course of the hearings requested that Nashville Gas furnish the necessary information to calculate the net revenue effect of the sales to the three industrial customers. The company refused to furnish the necessary information contending that Tennessee Natural is regulated by the Federal Power Commission and that such information was irrelevant and immaterial to the proceeding below.

For a twenty-five year period Tennessee Natural pas paid to its stockholders a divident which averages around 6-1/2% to 7% based on the book value of Tennessee Natural's common stock. In the year 1974 the dividend was 7.14%; 6.84% in 1973 and 6.91% in 1972. From time to time during this same twenty-five year period Tennessee Natural has extended its credit to Nashville Gas Company to help it in raising money needed for its operations.

Based on these facts, the Commission felt justified in imputing to Nashville Gas the rate of return effect of the revenues derived from the sales of Tennessee Natural to the three large industrial customers. The Court is of the opinion that this was error on the part of the Commission.

There can be little doubt that the sales to these industrial customers are sales in interstate commerce. In *Panhandle Eastern Pipeline Company v. Public Service Commission of Indiana,* 332 U.S. 507 (1947), the Court said

"thus gas furnished to local utilities for resale is supplied unquestionably, both as to transportation and as to sale, in interstate commerce." The Commission has so construed these sales in its previous Order in 1969 in Docket No. U-5089. And the Commission in that case construed the regulation of such sales to be outside the scope of its jurisdiction. In doing so the Commission was construing the language of Section 65-403, Tennessee Code Annotated, which excepted from the Commission's jurisdiction any public utility engaged in interstate commerce which was governed or regulated by a Federal Board or Commission.

This Court does not pass on the correctness of the Commission's conclusion in construing T.C.A. §65-403. As a matter of Federal law under the decision in *Panhandle Eastern, supra,* the Commission would have jurisdiction over the sales. However, the authority of the Commission may be further fixed by State law and the Commission's interpretation of that law may or may not be correct, but the Court is of the opinion that the Commission was correct in recognizing these sales as being sales in interstate commerce. The Court's opinion does not turn on the authority of the Commission to regulate these sales but it is affectedby the conclusion that these sales are in interstate commerce.

The Commission's Order is an attempt to regulate indirectly the sales in interstate commerce by Tennessee Natural. In doing so the Commission attempts to ignore not only the distinct corporate entities but seeks to treat the interstate business of Tennessee Natural as if it were intrastate business of Nashville Gas. A whole different set of rules, regulations questions and criteria apply to interstate business as contrasted to intrastate business. In *Simpson v. Shepard,* 230 U.S. 352, 33 S. Ct. 729, 57 L. ed. 1511 (1913), the Court said:

> "Where the business of the carrier is both interstate and intrastate, the question whether a scheme of maximum rates fixed by the state for intrastate transportation affords a fair return, must be determined by considering separately the value of the property employed in the intrastate business and the compensation allowed in that business under the rates prescribed... the state car not

justify unreasonable low rates for domestic transportation considered alone, upon the ground that the carrier is earning large profits on its interstate business. . . "

Even if Nashville Gas and Tennessee Natural were one and the same, it is the opinion of the Court that the business would have to be segregated into its intrastate and interstate components and rates set that were just and reasonable, taking into consideration the factors to be applied to each component of the business. The function of the rate making is to set a just and reasonable rate of return on property dedicated to the public. By attempting to treat the property of Tennessee Natural as if it were used in the intrastate operations of Nashville Gas, the Commission has violated an elementary principle of utility regulation. See *Simpson v. Shepard, supra; Smith v. Illinois Bell Telephone* 282 U.S. 133, 51 S. Ct. 65, 75 L. ed. 255; *Colorado Interstate Gas Co. v. Federal Power Commission,* 324 U.S. 581, 54 S. Ct. 829, 89 L. ed. 1026 (1945); American Jurisprudence Carriers, Section 130, page 520; C.J.S. Public Utilities, page 1046.

The Same principle applies to regulated versus nonregulated activities of the same corporation. *United Gas Pipeline Co. v. Federal Power Commission,* 388 F.2d 385 (Fifth Circuit 1968). *Panhandle Eastern Pipeline Co. v. Federal Power Commission,* 324 U.S. 635, 65 Sup. Ct. 821, 89 L.ed. 1241 (1945).

Therefore, the Court concludes that the action of the Commission in seeking by its order to impute the earnings of Tennessee Natural in its interstate operations to Nashville Gas involved solely in intrastate operations was beyond the scope of its authority and should be reversed.

II

The Commission in its order adjusted the gas volumes sold during the test period to reflect that the period was warmer than normal. The Commission calculated the degree day deficiency by using the thirty-year moving average as "normal". Using this method the Commission found that a

normal year would have a 3662 degree day deficiency.

The company introduced testimony to show that the normal degree day deficiency amounted to 3283. This figure was arrived at by the company's witness attempting to establish that the weather was in a certain cycle which could be predicted. The prediction was that the weather would continue to be warmer than usual.

Of all the assumptions that go into a rate-making proceeding which our Supreme Court has likened to looking through the "dim lense of prophecy" this is perhaps the dimmest that this Court has had to consider. In such a case it is helpful to get the latest information available to show what the actual sales have been. At the hearing the Commission offered proof showing that through November of 1975 thycompany had actually sold 18,558,707 Mcf of gas. Further, the company estimated that for the month of December it would sell 2,291,667 Mcf. That would total for the year 20,850,384 Mcf of actual sales. The Commission's adjustment incorporated in its Order forecast 21,212,087 Mcf of sales for the company. Therefore, for the year 1975 it appears that the Commission's Order resulted in an over-estimate of sales by 1.7%, assuming that the December sales were as predicted.

It appears to the Court that the figures used by the Commission are reasonable, have a rational basis and have proved to be fairly accurate for at least one eleven-month period. Therefore, it is the opinion of the Court that there is no error contained in the Commission's weather normalization method.

Another factor affecting the estimate of the gas to be sold was the Commission's estimate that the company will sell 95% of the gas it is entitled to purchase. In addition the Commisison estimated that the company would sell 95% of the gas allocated to the liquiefied natural gas tank which is now owned by Tennessee Natural.

The company's estimate of the volumes which it will be able to sell is much lower.

The Court is of the opinion that with the exception of the volume of gas in the LNG tank the Commission's determination is based on substantial and material evidence in the record and should not be disturbed. However, the LNG tank is not a source of natural gas but is used strictly for protection of high priority customers during times when the temperature is below 38 degrees fahrenheit. In some years the volume of gas in the tank may be substantially used up. In other years only small amounts may be used. For the winter of 1974-75, 132,100 Mcf were withdrawn from the tank during the heating season. The use of the gas in the tank is one that addresses itself to the sound descretion of company management. To charge them with the duty of completely depleting the gas stored in the tank each year is, in the opinion of the Court, an unjustified interference in the discretion of the company management. Therefore, it is the judgment of the Court that the figures used by the Commission, minus the 848,000 Mcf allocated to the tank would be reasonable.

III

The Commission in its Order allowed a depreciation rate of 2.5% on all plant in service prior to January 1, 1970. A rate of 4% was allowed on all additions since January 1, 1970.

The company's witness, Mr. Nichol, testified that based on the depletion of gas supply by 1990 a depreciation rate of 9.58% would be required to recover the expenses of installing the system. He, however, recommended a rate of 6.11% taking into account unknown factors such as increased supply which may become available in the future.

There is evidence in the record that the downward trend of gas supply may be reversed about 1980. This is the chief factor in determining a useful life of the company's plant. The evidence in the record shows that the plant would have a life far in excess of the 1990 date if it is properly maintained. Therefore, the Court concludes that the Commission's determination of the proper depreciation rate has a rational basis and should not be disturbed.

IV

The company filed Exhibit H-34 showing its estimated expenses in presenting this case to the Commission to be $203,420.00. The commission in its Order found this to be an exorbitant figure, especially in the area of consultant costs, and reduced the amount to be included in the cost of service to $100,000.00.

The Court is of the opinion that the Commission's action in cutting the amount allowed as Commission expense was arbitrary and not based on any evidence in the record. In fact, the only evidence before the Commission was that of the company. Therefore, the full amount of $203,420.00 amortized over a three-year peirod should be included as the regulatory Commission expense.

V

Having found certain adjustments to be made as indicated above, the Court is of the opinion that the rate of return of 13.5% to equity is fair and reasonable. Therefore the Commission's Order should be modified to allow the company to put into effect rates which will produce a return of 13.5% to equity with the adjustments as indicated in this opinion.

Mr. Kelley will prepare an appropriate order. Let the costs be taxed to the Commission.

/s/ BEN H. CANTRELL, CHANCELLOR

This 24th day of March, 1976.

APPENDIX J

IN THE
CHANCERY COURT OF DAVIDSON COUNTY, TENNESSEE
AT NASHVILLE, PART ONE

NASHVILLE GAS COMPANY	)	
	)	
	)	
VS.	)	NO: A-6395
	)	
	)	
TENNESSEE PUBLIC SERVICE COMMISSION, ET AL	)	
	)	

ORDER

This cause came on to be heard on February 19, 1976, before the Honorable Ben Cantrell, Chancellor, holding Part One of the Chancery Court of Davidson County, Tennessee, upon the motion of the defendant, Tennessee Public Service Commission, argument of counsel, and the record in this cause. Whereupon, the Court took said cause under advisement and found by Memorandum Opinion dated February 23, 1976 as follows, to-wit:

"This cause came to be heard on the 19th day of February 1976 on the motion of the defendant, Public Service Commission, to require the petitioner to answer certain interrogatories. After consideration of the argument of counsel, the scope of the inquiry included in the interrogatories and the fact that the case is now set for final hearing on February 26, 1976, it is in the opinion of the Court that the motion should be denied.

While it is true that the Court is required to consider the latest data available on the question of confiscation, the circlmstances quoted above prevent this case from falling within of that rule. In addition counsel for the respondent Commission argued at the hearing on the temporary injunction that the case was ready to be tried, the record was complete and on file, and the case should be given an expeditious hearing.

The ruling on the motion herein does not affect the right of the respondent Commission to introduce other proof at the hearing.

Mr. Kelley will prepare the order reflecting the ruling in this Memorandum."

IT IS ACCORDINGLY ORDERED, ADJUDGED AND DECREED by the Court that pursuant to the Court's findings set forth above, the motion of the defendant, Public Service Commission, is hereby disallowed and overruled.

Enter this _____ day of _______ , 1976.

/s/ BEN H. CANTRELL, CHANCELLOR

APPROVED FOR ENTRY:

ORTALE, KELLEY, HERBERT & CRAWFORD

BY: /s/
Attorneys for Plaintiff

CERTIFICATE OF SERVICE

The undersigned does hereby certify that a copy of this Order has been placed in the United States Mail, postage prepaid, to all counsel of record in this cause on this 11th day of March, 1976.

/s/ JOHN W. KELLEY

APPENDIX K

NASHVILLE GAS COMPANY	)	IN THE CHANCERY
	)	COURT,
	)	PART ONE,
VS. NO. A-6395	)	AT NASHVILLE
	)	
	)	
	)	
TENNESSEE PUBLIC SERVICE	)	
COMMISSION, ET AL	)	

ORDER

This matter came on to be heard on January 10, 1975, on the Motion of the Plaintiff, Nashville Gas Company, to reconsider the decision of the Chancellor in this proceeding as set forth in the Memorandum Opinion issued December 23, 1975.

From the record before the Chancellor, including the argument of counsel, the Chancellor is of the opinion that the Motion is not well taken and should be denied.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED, That the Motion to reconsider of the plaintiff should be overruled.

CHANCELLOR

APPROVED FOR ENTRY:

/s/ EUGENE W. WARD

/s/ T. E. MIDYETT, JR.

Counsel for defendant, Tennessee
Public Service Commission

/s/ JOHN W. KELLEY
Counsel for Plaintiff, Nashville
Gas Company

/s/ LARRY WOODS
Counsel for Intervenor

APPENDIX L

NASHVILLE GAS COMPANY	)	
	)	IN THE CHANCERY
VS. NO. A-6395	)	COURT,
	)	PART ONE,
TENNESSEE PUBLIC SERVICE	)	AT NASHVILLE.
COMMISSION, ET AL	)	

DECREED:

This cause came on to be heard before the Honorable Ben H. Cantrell, Chancellor, on December 15, 1975, upon the application of the plaintiff, Nashville Gas Company, for a temporary injunction preventing the enforcement of the order of the defendant, Tennessee Public Service Commission of October 14, 1975 and allowing the plaintiff to put into effect, under bond, the rates sought before the Commission.

Based upon the record, including the affidavits filed by both the plaintiff and the defendant, and the briefs and arguments of the parties, for the reasons set out in the Memorandum Opinion of the Chancellor issued December 23, 1975, which Memorandum is incorporated and made a part of this Decree by reference, the Court is of the opinion that the application for a temporary iinjunction should be denied.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED:

1. That the application of the plaintiff for a temporary injunction should be denied.

2. That this cause should be set for trial on its merits at the earliest practicable date.

Entered this ____ day of ____ , 1976.

CHANCELLOR

APPROVED FOR ENTRY:

/s/ EUGENE W. WARD

T. E. MIDYETT, JR.

Counsel for defendant, Tennessee Public Service Commission

/s/ JOHN W. KELLEY
Counsel for Plaintiff, Nashville Gas Company

/s/ LARRY WOODS
Counsel for Intervenor, Clifford Allen

APPENDIX M

NASHVILLE GAS COMPANY	)	
	)	IN THE CHANCERY
VS. NO. A-6395	)	COURT,
	)	PART ONE,
TENNESSEE PUBLIC SERVICE	)	AT NASHVILLE.
COMMISSION, ET AL	)	

MEMORANDUM

This cause is before the Court on the application of the plaintiff, Nashville Gas Company, for a temporary injunction preventing the enforcement of the defendant Commission's order of October 14, 1975, and allowing the plaintiff to put into effect under bond the rates sought in the application below The defendant Commission has filed its answer and Clifford Allen and Charles Friddell have intervened and filed an answer as defendants.

The complaint alleges that the Commission's order is confiscatory because it allows the plaintiff to collect rates below those that are "just and reasonable". In the Commission's order a majority of the Commission found that the plaintiff was entitled to a return of 12.14 percent on the rate base as found by the Commission and 13.05 percent on common equity. However, the Commission's order withheld $1,147,044.00 because of some unanswered questions the Commission had concerning the petitioner's relationship with its parent, Tennessee Natural Gas Lines, Inc. It is this part of the Commission's order that is most objected bto by the plaintiff. The other matters complained of include the Commission's conclusions concerning the volumes of gas to be sold, depreciation, regulatory commission expense, and the Metro franchise fee.

The affidavits on file concerning the rate of return and return to equity are inconclusive respecting the degree of confiscation purportedly caused by the

Commission's order. Taking the plaintiff's affidavits as true, it does appear that the Commission's order may result in revenues which would be insufficient to rise above the lower limits of the zone of reasonableness. However, the analysis submitted by the Commission casts some doubt on the plaintiff's contention. Further, the crux of the entire claim by the plaintiff may be the right of the Commission to impute earnings of the parent company to the subsidiary. While the reasonableness of this act by the Commission is not free from doubt, it does not appear to the Court that it is on its face arbitrary or illegal. Therefore, the determination of that question should await a full hearing on the merits.

From all of the above it appears to the Court that the plaintiff has failed to make out a prima facie case of confiscation and show such immediate and irreparable harm to persuade the Court to allow the higher rates to go into effect under bond. Therefore, the application for a temporary injunction should be denied.

It further appears that the record below has been filed with this Court and the case is ready for disposition on the merits. Due to the nature of the claim it appears that it should be disposed of at the earliest practicable date. The Court will entertain a motion to set the case as soon as it can be heard, consistent with the schedules of the parties.

Mr. Midgett will prepare the decree.

/s/ BEN H. CANTRELL, CHANCELLOR

This December 23, 1975
xc: Mr. John W. Kelley
Mr. Tom Midyett
Mr. Eugene Ward
Mr. Lary Woods
Mr. Leslie Enoch
Mr. William W. Bedwell

"It appears that the Natural Gas Act was enacted by Congress on June 1, 1938, and that these Respondents were referred to

STATE/FEDERAL NEWS...standing head
OREGON

Chief Justice Calls for New Methods

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

APPENDIX N

TO THE CHANCELLORS OF THE CHANCERY COURT

AT NASHVILLE, DAVIDSON COUNTY, TENNESSEE

NASHVILLE GAS COMPANY, a corporation organized and existing under the laws of the State of Tennessee, Plaintiff,	)	
Vs.	)	RULE NO. A6395
TENNESSEE PUBLIC SERVICE COMMISSION, CAYCE L. PENTECOST, Z. D. ATKINS, and ROBERT N. CLEMENT, COMMISSIONERS, composing the membership of said Tennessee Public Service Commission, residing and having their principal office in Nashville, Davidson County, Tennessee, Defendants.	)	

ORIGINAL BILL OF COMPLAINT AND PETITION FOR CERTIORARI

Plaintiff respectfully shows to the Court as follows:

1. Plaintiff, Nashville Gas Company ("Plaintiff" or "Petitioner" or "Company" herein), is a corporation chartered and doing business under the laws of the State of Tennessee. It is engaged in the distribution and sale, at retail, of natural gas to customers located in Davidson County, Tennessee and in portions of Sumner, Cheatham, Williamson and Wilson Counties, Tennessee. The Company's principal office is located in Nashville, Davidson County, Tennessee. The

Company is the sole distributor of natural gas in the areas served by it. In turn, it purchases its total supply of natural gas from its parent corporation, Tennessee Natural Gas Lines, Inc. ("Tennessee Natural"), an interstate natural gas pipeline company which is regulated by a federal agency, the Federal Power Commission ("FPC" herein).

2. The Defendants, Cayce L. Pentecost, Z. D. Atkins, and Robert N. Clement, are the duly elected, qualified and acting members of, and comprise, the Tennessee Public Service Commission ("Defendants" or "Commission" herein). Said Commissioners and said Commission have their respective offices in Nashville, Davidson County, Tennessee. Said Commission is a body established by the laws of the State of Tennessee and is vested by statute with various regulatory powers and authority over certain public utilities, including intrastate natural gas distribution companies, and possesses administrative, quasi-legislative and quasi-judicial powers subject to applicable statutory and constitutional limitations as hereinafter more specifically set forth. Pursuant to such authority, the Commission regulates the rates and quality of service of the Plaintiff Company.

3. Because of an emergency situation facing it,[1] on January 16, 1975 the Company filed a petition to place into effect revised rates in Commission Docket No. U-6098. The Company made clear both in its petition and at the hearing that such revised rates were not adequate to provide a just and reasonable rate of return but, instead, were strictly a "stop gap" emergency measure to assist it in its then-pending financing. The Company further made clear that it would soon thereafter file additional revised rates adequate to provide a just and reasonable rate of return. A hearing was held on February 12, 1975 concerning the emergency rates

[1]The Company had $10,000,000 of First Mortgage Bonds coming due on August 1, 1975 and insufficient operating revenues to enable it to re-finance such long-term debt.

involved in Docket No. U-6098 and, by its order issued March 13, 1975, the Commission permitted rates to go into effect on March 13, 1975, under bond subject to refund, designed to yield approximately 1.7 million dollars in additional annual revenues.

4. On April 14, 1975 in Docket No. U-6142, the Company filed the new revised rates, referred to above, designed to produce a just and reasonable rate of return. Those rates were proposed to become effective "as soon as permitted by law." By its order issued May 13, 1975, the Commission suspended such new revised rates pending investigation and hearing. The Company filed its prepared testimony and exhibits in support of the revised rates in Docket No. U-6142 on May 23, 1975. Hearings were held before the full Commission on September 3-5, 9-12, 23-26, 29, and October 1, 1975. At the beginning of the hearings, on motion by Commission Assistant General Counsel, the proceedings at Docket Nos. U-6098 and U-6142 were consolidated.

5. On October 14, 1975, Commissioners Pentecost and Clement (Commissioner Atkins dissenting on one point to be discussed hereinafter) issued the order here complained of. In such order, the Commission determined that the Company was entitled to rates which would produce a rate of return to equity capital of 13.5% (12.14% overall rate of return on the rate base determined by the Commiss on). The Commission held that 13.5% on equity was "fair and reasonable and in keeping with the [constitutional] principles laid down in the *Hope* and *Bluefield* decisions."

6. However, due to the egregious errors committed by the Commission hereinafter detailed, the Commission guaranteed that the Company could not come close to earning the return to which the Commission thus found the Company entitled. As more particularly stated hereinafter, and as recognized in Commissioner Atkins' dissenting opinion, the Commission arbitrarily and capriciously ignored the

uncontroverted evidence of record, deprived the Company of due process of law, and confiscated the Company's property in violation of Article I, Sections 8 and 21 of the Constitution of Tennessee and of the Fifth and Fourteenth Amendments to the Constitution of the United States by its actions in the following six considerations.

I

PARENT - SUBSIDIARY RELATIONSHIP

7. Plaintiff alleges that the most blatant error committed by the Commission (and the ground upon which Commissioner Atkins specifically dissented) was as follows: The Commission found that, in order to achieve the rate of return found to be necessary, the Company is entitled to collect increased revenues of $3,056,132 annually. Due to its errors in estimating volumes of gas to be sold (hereinafter discussed), it determined that the emergency rates in Docket No. U-6098 would recover $1,909,088 (rather than $1.7 million) of this amount, leaving $1,147,044 of increased annual revenues to be recovered from the rates in Docket No. U-6142.

8. However, the Commission's order permitting the filing of increased rates did not allow rates to recover the $1,147,044 found to be necessary, but instead ordered rates to be filed which would produce only that amount *less* net revenues realized by Tennessee Natural on sales made by that interstate company to three of its own customers, to-wit Dupont, Ford and Armstrong (formerly Gates Rubber Co.). This "imputation" of profits earned by Tennessee Natural on sales to its own customers was without any basis in fact or in law. While the exact figures on Tennessee Natural's profits on its sales to said three customers are not, at the filing of this Complaint, known to Plaintiff, the effect of the Commission's order is to confiscate the Plaintiff's property to that extent by withholding from Plaintiff the rate of return found by the Commission itself to be necessary; and even to delay

Plaintiff's right to any portion of said $1 147,044 pending computation and furnishing to the Commission of the data respecting Tennessee Natural's revenues, expenses and investment associated with the sales made by that Company is confiscatory. Plaintiff avers that Tennessee Natural and Plaintiff are separate corporations, each carrying on a business and performing a function separate and distinct from that of the other, Tennessee Natural being an interstate natural gas pipeline company as defined in the federal Natural Gas Act, certificated and regulated by the FPC, and Plaintiff being an intrastate gas distribution company certificated and regulated by the Tennessee Public Service Commission; and imputation of the revenues, expenses and investment of the business of either to the other is without justification in law or equity, and is illegal, arbitrary and capricious action on the part of the Commission and results in confiscation.

9. The order signed by the Commission majority makes no claim, as indeed it could not, that there was any impropriety involved in sales to the three customers in question being made by Tennessee Natural rather than by the Plaintiff. Although the Commission stated no reason for its "imputation," Plaintiff can only assume that, in their eagerness to find ways to reduce Plaintiff's revenues, the majority concluded (contrary to the voluminous uncontroverted evidence of record on the point) that, at the time Tennessee Natural's said sales were commenced, the three customers of Tennessee Natural were "located within the certificated area of Nashville Gas Company;" and that thus, the Company, rather than Tennessee Natural, should be the seller. The Commission in its order "posed" three questions (Order, p. 34) and then proceeded to ignore the facts in answering the questions.

10. Plaintiff avers that the uncontroverted evidence on the point shows conclusively that: at the time the sales in question were commenced, the three customers were outside the Plaintiff's certificated service area and it was not until some years later that Plaintiff's certificated service area was

expanded to include the areas in which said Tennessee Natural's three customers were located;[2] the sales in question were certificated by the FPC to be made by Tennessee Natural, the FPC being the body which regulates Tennessee Natural pursuant to the federal Natural Gas Act;[3] and, at the time the sales in question commenced, Plaintiff lacked the physical, legal, and financial ability to make such sales and such inability continues to the present time.

11. The majority made no attempt to assert that the Commission could require that the sales to the three customers in question be terminated by Tennessee Natural and taken over by Plaintiff, as was urged by an Intervenor in the proceedings. Obviously recognizing that this could not legally be done, the Commission majority chose to create a fiction by "imputing" the sales to Plaintiff *as if* the sales were in fact made by Plaintiff, although in fact they have never been so made and neither in fact nor in law can they be so made.

[2]One of the majority, Chairman Pentecost, was well aware of this fact during the hearing. On this very point, at Tr. 569 (9-12-75) he stated:

> "The Chairman: Senator, I think that the answer to your question is that in 1963 when Metropolitan Government came about, the Commission included the entire county of Davidson as the city limits of Nashville, and therefore allowed the Gas Company to go outside the old original city limits."

The uncontroverted evidence shows that sales to the three customers in question were commenced in 1951, 1956, and 1959, respectively, and that, as recognized by Chairman Pentecost in the foregoing quotation, the three customers were outside Plaintiff's certificated service area until 1963.

[3]Had the Commission deemed the three Tennessee Natural customers to be within Plaintiff's certificated area, the Commission, of course, could have participated in the proceedings before the Federal Power Commission and could have urged that the sales in question be made by the Plaintiff rather than by Tennessee Natural. It did not do so but, instead, some 24 years later attempts to "impute" revenues from such sales.

12. Plaintiff avers that the Commission does not regulate Tennessee Natural and the Commission so expressly recognized in 1969; and thus the Commission majority attempted to do indirectly that which it is barred from doing directly. On February 7, 1969, the Commission issued an order in consolidated Docket Nos. U-5089 and U-5088, specifically holding that the Commission had no authority over Plaintiff's parent Tennessee Natural, and the reasons therefor.[4] Plaintiff alleges that the following quotation from the unanimous holding of the Commission in 1969 shows the complete absence of jurisdiction in the Commission to do what it has now attempted in its order in the present case:

> "On July 24, 1968, this Commission issued show cause orders in these dockets to the Respondents to appear before the Commission and show cause, if cause they had, why they should not be declared to be 'public utilities' and subject to the rules and regulations of this Commission. . . .
>
> * * * * * *
>
> "Tennessee Natural Gas Lines, Inc. obtained a certificate of convenience and necessity from the Federal Power Commission authorizing it to construct and operate its gas facilities on December 29, 1945, in F.P.C. Docket G-575. The Federal Power Commission's order provides as follows:
>
>> 'Section (A) A certificate of public convenience and necessity be and it is hereby issued authorizing the construction and

[4]Docket Nos. U-5089 and U-5088 (consolidated) was a show cause proceeding to determine whether the Tennessee Public Service Commission had any regulatory jurisdiction with respect to the business of Tennessee Natural (U-5089) and with respect to the business of another interstate pipeline carrier, Tennessee Gas Pipeline Company (U-5088).

>> operation by the Applicant of the proposed facilities . . . subject to the jurisdiction of the Commission [F.P.C.] upon the terms and conditions of this order, provided that the rates and charges of Applicant for sale of gas to Nashville Gas shall be approved in advance by this Commission [F.P.C.] and shall not include costs other than are found to be just and reasonable.'
>
> "The customers of Tennessee Natural Gas Lines, Inc., are Nashville Gas Company, Nashville, Tennessee; *E.I. Dupont De Nemours*, Old Hickory, Tennessee; *Ford Motor Company*, Nashville, Tennessee, and *Gates Rubber Company*, Madison, Tennessee. [Emphasis Added. These are the three customers in question.]

"It appears that the Natural Gas Act was enacted by Congress on June 1, 1938, and that these Respondents were referred to as 'Natural Gas Company.' 16 USC 717 a(6) defines such a company as follows:

> ' "Natural gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.'

"The case of F.P.C. v. East Ohio Gas Co., 338 U.S. 464 has held that a transmission company, although wholly within a single state, which receives gas in a continuous flow from outside the state, is nevertheless, engaged in interstate commerce.

* * * * * *

"Tennessee Code Annotated, Section 65-403 provides as follows:

'65-403. Interstate commerce excepted. – The provisions of this chapter shall be construed to apply to and affect only public utilities which furnish products or services within the State, *and this chapter shall not be construed to extend to any public utility engaged in interstate commerce* for the government or regulation of which jurisdiction is vested in the interstate commerce commission or other federal board or commission. (Acts 1919, ch. 49, Section 10; Shan. Supp., Section 3049a93; Code 1932, Section 5456.)' [Emphasis Added]

"From the foregoing Code Section, it appears that if a Company is engaged in interstate commerce, as these Respondents have been so declared to be engaged by the Federal Power Commission, and the regulation is vested in the federal board or commission, the provisions of the chapter relative to regulation by this Commission do not apply.

"This Commission has only such jurisdiction as is expressly conferred upon it by statute.

Pharr vs. N.C. & St. L., 186 Tenn. 154

Tennessee-Carolina v. Pentecost, 206 Tenn. 551

"From our consideration of the entire matters in these causes, together with the show cause orders issued herein; the motions for dismissal and the briefs in support thereof; oral argument of counsel and our own independent investigations, the Commission is of the opinion that the Respondents are Natural Gas Companies as defined under the Natural Gas Act of 1938 and are engaged in interstate commerce and are regulated by the Federal Power Commission, and that this Commission does not have jurisdiction to regulate these Respondents, as set forth in the Commission's show cause orders heretofore issued."

13. Aside from the question of whether or not a state *can* provide for its regulatory commission to regulate the rates for sales of gas made to direct industrial customers by an interstate pipeline company, the above-quoted Section 65-403 of Tennessee Code Annotated clearly prohibits the Tennessee Commission from doing so. It expressly denies jurisdiction, totally, over a *company* engaged in interstate commerce, etc., not merely over certain aspects of its operations.

14. Plaintiff alleges that what the majority has here attempted is even more vicious than a direct attempt to regulate the rates for these sales in that it attempts to ignore the separate corporate entities and separate functions of the Company and its parent. Plaintiff avers that, even if the Tennessee Commission could regulate the rates for these sales by Tennessee Natural, it could not apply the revenues to Tennessee Natural therefrom as a credit against Nashville Gas Company's cost of service. The following excerpts from Commissioner Atkins' dissent clearly point out the errors committed by the majority:

"There are no facts shown in the present case which can justify imputing to Nashville Gas Company any of the revenues, expenses and investment of Tennessee Natural. The three customers in question were being served by Tennessee Natural, under legal contracts between those parties, for many years before those areas were brought within the Metro area and the Nashville Gas franchise area. There is no claim made in the Order, as indeed there could not be, that there was any impropriety in Tennessee Natural serving its three industrial customers.

"Furthermore, the record in this case is abundantly clear that at no time prior to, or at, the time Tennessee Natural initiated service to the three customers did Nashville Gas have the physical, legal, or financial ability to serve such customers, and it still lacks that ability. Apparently recognizing this, the action of the other Commissioners attempts to achieve the same result, indirectly, under the guise of setting the rates of

Nashville Gas by imputing to that company the revenues, etc., of Tennessee Natural. (Page 7)

* * * * *

"As shown in this record, the Natural Gas Act of 1938 provides that a natural gas company has the authority to sell natural gas directly off its interstate pipeline to industrial customers, subject to FPC approval of facilities to serve and specific volumes of natural gas to be sold. The sales by Tennessee Natural to its three industrial customers were certificated by the Federal Power Commission to be made by Tennessee Natural. The proof in this record is clear that the gas sold by Tennessee Natural to these customers never leaves the interstate pipeline system; never flows through a Nashville Gas Company City Gate Station, and thus never touches the jurisdiction of this Commission. (Pages 7-8)

* * * * *

"In conclusion, it gives me great concern that this Commission, after a protracted hearing as has been had in this case, can on the one hand, find a required fair rate of return and then, under the guise of waiting for the filing of information that must be ottained from the records of a company not under control of Nashville Gas Company and not regulated by this Commission, withhold a substantial portion of the revenue that the Company is entitled to and must have to enable it to carry out its obligation to serve the public and earn a fair rate of return as found by this Commission, is, in my opinion, clearly in contravention with the principle of law as determined in the Bluefield Water Works v. Public Service Commission of West Virginia case, 262 U.S. 679, 67 L. ed. 1176, 43 S. Ct. 675(1923), which simply said that public utility company is entitled to a fair rate of return on its investment used and useful in providing service to its customers or subscribers." (Page 8)

15. Additionally, Plaintiff alleges that the uncontroverted evidence shows that: once the sales in question were commenced by Tennessee Natural pursuant to the certificates of public convenience and necessity issued by the FPC, that company could not terminate such sales except upon such termination being approved by the FPC; in light of the current shortage of natural gas and the Federal Power Commission's policies resulting therefrom, any attempt to have Tennessee Natural terminate the three sales in question and to have Plaintiff undertake them would, in all likelihood, result in denial and loss of gas service to the three customers involved; and, even if Tennessee Natural were willing to turn over the three customers to the Company, (the evidence shows it is not), in order for the Plaintiff to make such sales it would have to construct additional facilities at a cost so great as to make the same economically unfeasible (for example, the proof shows that to take over the Dupont sales, the Company would be required to construct additional facilities estimated to cost approximately $10,000,000 – this aside from the fact that Plaintiff would have an insufficient gas supply to make the sale).

16. Plaintiff avers that the majority's "imputation" is an attempt to disregard the separate corporate entities fo these two companies – one interstate, the other intrastate – without a scintilla of evidence that there was any impropriety involved in Tennessee Natural making the sale rather than the Plaintiff; as is directly contrary to the uncontroverted evidence of record that, at the time the customer relationships were established and sales commenced, Plaintiff was physically, legally, and financially incapable of making such sales. It is an attempt to accomplish indirectly that which the Commission is prohibited from doing directly, *i.e.*, regulation of a company engaged in interstate commerce which is regulated by a federal agency. This denial to Plaintiff of $1,147,044 of revenues which the Commission found to be required in order for the Plaintiff to achieve a fair rate of return, results in the unconstitutional confiscation of Plaintiff's property.

II.

VOLUMES OF GAS TO BE SOLD

17. The second major error committed by the Commission guaranteeing that the Company will not be able to realize the operating revenues to which the Commission found it entitled is the volumes of gas the Commission found that the Company would sell. This error in turn is two-fold: (a) an adjustment to sales volumes to estimate the sales the Company will make when "normal" weather is experienced based on a "normal" which the record shows is not likely to occur; and, (b) the assumption, contrary to the uncontroverted evidence of record, that the Company will be able to re-schedule its gas purchase entitlements so that it could sell 97% of the total volumes of gas the Company is entitled to purchase. To illustrate the significance of these errors, Plaintiff would point out that the Commission determines the total annual revenues to which the Company is entitled and then divides such revenues by the annual volumes to be sold so as to derive the per unit rate to be charged. It is obvious that, if the volumes used in deriving the rates are higher than will be actually sold, the Company will not realize the operating revenues to which it has been determined to be entitled.

A. Weather Normalization

18. Since the gas utility business is so extremely weather sensitive, the Commission attempts to estimate the volumes of gas which will be sold by the particular company when "normal" temperatures are experienced. It does this by adjusting the temperature-sensitive portion of the utility's load in accordance with the actual usage per Degree Day Deficiency ("D.D.D.") according to the actual experience of the particular utility for the various classes of customer, multiplied by the total number of D D D.'s which are "normal" for the period in question—usually, as in this case, for a year. Generally, the temperature-sensitive portion of a

utility's load only varies when the temperature falls below 65°F. One D.D.D. is each degree by which the mean temperature on a day is less than 65°F. For example, if the mean temperature on a day is 50°F., there would be 15 D.D.D.'s on that day. From actual records of gas sales and D.D.D.'s, usage of gas by the temperature-sensitive portion of the utility's load per each D.D.D. is determined. This amount of gas usage per D.D.D. is then multiplied by the total number of D D.D.'s projected to occur in a future period (daily, monthly, seasonally, etc.) to determine the gas sales to the temperature-sensitive portion of the utility's load during such future period, on the basis of D.D.D.'s expected to occur in that period. The Commission error to which this subsection "A" relates is its error in assuming the D.D D.'s which will occur in a "normal" winter.

19. The Commission has traditionally used the 30-year moving average D.D.D.'s as "normal" for rate-making purposes, apparently without too much scrutiny to determine whether or not such a "normal" was appropriate for rate-making purposes. In this proceeding, the evidence shows that the Company's expert witness made a comprehensive study of the appropriateness of using the 30-year moving average D.D.D.'s, together with appropriate tests of his conclusions. The record demonstrates that the use of a 30-year moving average D.D.D. is not appropriate for rate-making purposes in that it ignores any obvious and clearly observable trends as well as shorter term actual weather. Using the clearly observable trends which his study had revealed, this Company's expert determined the proper "normal" D.D.D.'s which should be used to be 3,283, as compared to the 3,662 used by the Commission Staff's witness and adopted by the Commission. The difference in setting rates on the basis of these two "normal" D.D.D.'s is approximately $1,595,466 in revenues to the Company, i.e., if the rates are set on the basis used by the Commission and then the "normal" temperatures are experienced as predicted by the Company's expert, then the Company will fall short of recovering the revenues to which it has been found entitled by approximately $1,500,000.

20. The Company's rates were set in 1972 on the same weather normalization basis as used by the Commission in this proceeding. The Commission Staff's witness admitted on cross-examination that, since that time, the Company had never achieved the rate of return there found just and reasonable because the weather normalization there used had never been experienced. He further admitted that most of the other gas utilities had likewise failed to earn their allowed rates of return for the same reason.

21. The Company's expert witness testified without contradiction that the determination of the "normal" weather used for setting rates is much more critical in times of a shortage of supply, as now exists, than during periods when supply is plentiful for the following reason. Over a period of time, actual temperatures experienced will be both above and below the average for the total period and might be expected to tend to average out over a long period of time. Thus, in periods of plentiful supply, it would be expected that a utility would sell more gas in colder than "normal" winters which would offset sales of less gas in warmer than "normal" winters. But under curtailment conditions which have now existed for some time and which will continue to exist in the foreseeable future, as shown in the evidence, the Company does not have, and will not have, the gas supply to meet the greater customer requirements generated by the colder than "normal" weather and thus cannot offset the lesser sales made in warmer than "normal" winters. The volumes to be sold in the "normal" winter upon the basis of which the utility's rates have been set becomes a ceiling and can never become an average of sales expected to be made.

22. Plaintiff alleges that the uncontroverted evidence showed that, since the winter of 1970-71, the actual winter total D.D.D.'s have never been as high as the "normal" used by Staff and adopted by the Commission and that there has been a decided observable downward trend in such winter D.D.D.'s which is still continuing. The Company's uncontroverted evidence showed that a 30-year moving

average will never reflect a prolonged period (5 years and more) of abnormal temperatures to any appreciable extent.

23. The Commission ignored the extensive record made as to the appropriate weather normalization procedure to be followed and specifically the facts shown by the record as recited above. It instead used the 30-year moving average with no more support than the fact that it had used that method in prior cases and, specifically, in this Company's last rate case in 1972, in spite of the fact, as noted *supra*, that the Commission Staff's own witness admitted on cross-examination that, because of the weather normalization used in that case, this Company had never achieved the rate of return there found to be just and reasonable.

24. In addition to overstating the total volumes of gas expected to be sold (and thus reducing the rates), the weather normalization method used by the Commission results in a further error (further reducing the rates) by shifting estimated volumes of sales used to set rates from the more cheaply priced "interruptible" category to the higher priced "firm" category. Again, the effect of this error is more sharply pronounced in periods of supply shortage when there is a limited volume of gas available for sale to all classes of service.

B. The Erroneous Assumption That the Company Can Sell 97% of the Natural Gas It Is Entitled To Purchase.

25. This error is intertwined with, but severable from, the error discussed in the preceding subsection "A" relating to the volumes of estimated firm sales used by the Commission based upon its weather normalization adjustments. For convenience of the Court in understanding this important aspect of the case, there is here set forth the following brief explanation of the manner in which there is established what amounts of gas a distributor is entitled to purchase during the current gas supply shortage situation.

(a) Most interstate suppliers of natural gas presently lack gas supplies sufficient to meet their contractual commitments. Additionally, they project reductions in supply over the next few years. The Company's sole supplier, Tennessee Natural, and the sole supplier to Tennessee Natural, are both among such interstate companies. As a result, interstate companies have in effect various "curtailment" plans, under supervision of the Federal Power Commission, which provide priorities of service based on the end-use of the gas, *i.e.*, a ranking of superior versus inferior consumption of natural gas in times of shortage.

(b) The curtailment plan of the Company's sole supplier, and its sole supplier, has a ranking of 9 priorities of service which range from Priority 1, residential consumption, to Priority 9, large volume boiler fuel consumption purchased on an "interruptible" basis. When Supply does not equal requirements, Priority 9 deliveries are curtailed completely before Priority 8 is curtailed and so on down the list of priorities.

(c) Under the curtailment plan of the Company's sole supplier, and its sole supplier, a market profile is prepared for each customer for each month, which places specific volumes of gas in the specific priority of service categories. The supplier then matches its estimated supply for a period (usually the succeeding winter season or summer season) to these prioritized customer requirements and determines which priorities of such requirements its estimated supply can meet for such period. The supplier then assigns and notifies each customer of its Contract Period Quantity Entitlement ("CPQE"), which is the maximum volume of gas such customer is entitled to purchase during such period, as well as separately during each month in the period. These CPQE's established by the supplier are monthly and seasonal limitations on the Company's purchases in addition to maximum daily limitations which exist even during periods when curtailment is not required. Heavy penalties are provided for exceeding these purchase limitations.

26. The Commission Staff's witness totalled the CPQE's for the winter and summer seasons, ignored the monthly CPQE, and added thereto the Company's allotment from its supplier's Liquefied Natural Gas ("LNG ') Storage. He completely ignored the fact that the uncontroverted evidence of record showed that such CPQE entitlements are established on a monthly basis and then assumed that the same could be switched between months and periods, contrary to the record evidence, which showed that such switches are not permitted. He further ignored the uncontroverted evidence of record showing that these CPQE's are estimates and that, in the past, when they have been in error, they have always been on the high side. He ignored the fact that, as shown by the evidence, unforeseen developments reduce these CPQE's, as occurred during the course of the hearings as the result of Hurricane Eloise hitting offshore gas producing facilities and causing a reduction in the Company's CPQE. He allowed for a 3% error and lag in dispatching and *assumed* that the Company could sell the balance (97%) of its *total annual* CPQE s.

27. With respect to adding into the total annual volume available for sale by Plaintiff, the allotment from the supplier's LNG Storage, the Company's uncontroverted evidence showed that such LNG Storage is strictly a "peak shaving" facility and is put into service only whenever the mean temperature is below 38°F.; that, thus, this volume cannot be considered as an additional CPQE available for sale—it is purely a safeguard to protect the system on a daily basis, based on temperatures and temperature patterns; it cannot be deemed an addition to the Company's total annual CPQE as used by the Staff.

28. The Company's uncontroverted evidence showed that, based upon its monthly and seasonal CPQE s, it would not have available for sale in the winter season the volume of gas forecast to be sold on a firm basis by the Commission Staff's witness as the result of his weather normalization adjustment without the transfer of summer CPQE s to the winter period and that such transfer is absolutely prohibited.

The Staff witness admitted that he had made no attempt to check to see whether or not the monthly CPQE's would allow the Company to actually sell the volumes of gas he had projected and that he had merely used the totals to arrive at an annual CPQE.

29. Apparently recognizing the validity of the Company's showing, during the hearing the Commission's Staff argued that the Company could sell, on an "interruptible" basis, the difference between the Company's projected "firm" sales and its annual gas supply entitlement, including LNG. If the Company's estimate of firm sales is accepted but the assumption of the Commission's Staff as to "interruptible" sales is used, the effect is to reduce the Company's revenues to $832,809 below those to which the Commission found the Company entitled. The Company's uncontroverted evidence showed that, in order to sell the Staff's estimated volume of "interruptible" gas, it would be required to indulge in gross mismanagement by operating its system in a manner which would jeopardize service to its firm customers in that sufficient quantities of natural gas might not be available for firm customers at the end of the winter period if supplies had already been exhausted by previous sales to interruptible customers.

30. The Commission Staff's witness made a purely mathematical calculation and substituted an *assumption* that 97% of the Company's total annual CPQE (plus LNG) would be sold contrary to the Company's uncontroverted *evidence* that the Company's system could not be so operated under actual conditions of supply and markets. In short, the Staff's witness substituted a mathematical computation for the operating judgment of the Company's personnel charged with the duty of operating the system and assuring service to its firm customers. The Commission ignored the voluminous uncontroverted evidence showing the foregoing facts and merely adopted the assumptions of the Commission Staff's witness as to the volume of first sales the Company will make and thus deprived the Company of $1,595,466 in revenues

which would be required to produce the rate of return to which it found the Company entitled.

III.

DEPRECIATION

31. Plaintiff avers that in addition to the errors hereinbefore detailed which will prevent the Company from earning the revenues and return to which the Commission found the Company entitled, the Commission committed additional errors in arriving at the level of revenues or rate of return to which the Company is entitled. A major Commission error in this category and one which has great financial impact is its treatment of depreciation.

32. The *only* evidence in the record relating to the proper depreciation rate to be used by the Company is that of the Company's expert witness Nicol. The Commission Staff's witnesses expressly disclaimed taking any position as to proper depreciation rate. Mr. Nicol showed that, based on a study of the currently available and committed supply of gas to the Company's sole supplier, such supply would be exhausted in the year 1990 and that, to fully depreciate the Company's facilities by then, a 9.58% rate of depreciation would be required. However, since he felt that to implement such a drastic change in depreciation rates would be disruptive, and in order to reflect the fact that the Company's supplier's supplier is exploring new sources and methods of supply (mostly non-traditional or "exotic' and none of it proven), he recommended a depreciation rate of 6.11%, approximately halfway between the present 2.5% and the 9.58% computed on the basis of presently committed supply.

33. The Commission, without any other evidence before it, completely discounted Mr. Nicol's evidence and attacked it

on the ground that it was based on a "worst case" basis,[5] *i. e.*, that it was based entirely upon presently committed supplies and did not take into account future additions to supply. In attacking Mr. Nicol's evidence, the Commission focused on Mr. Nicol's computed rate of 9.58% required to fully depreciate the Company's facilities based upon presently committed supplies, and completely ignored Mr. Nicol's recommended rate of 6.11%,[6] which takes into account additional future supplies, and Mr. Nicol's further recommendation that the Company's supply picture be continually monitored with an eye to revising the depreciation rate to be used as supply conditions warrant.

34. Plaintiff avers that, after completely ignoring the only evidence in the record relating to the proper rate of depreciation to be used by the Company, the Commission "pulled out of thin air" a rate of depreciation of 4% to be used on all property placed in service after January 1, 1970 but required that the old depreciation rate of 2.5% should continue to be used on all property placed in service prior to that date. The Commission did not even intimate a reason for its choice of a 4% depreciation rate on all post-1969 plant nor did it even give a hint as to its reasoning behind its conclusion that the old 2.5% rate should continue to be used on

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[5]The evidence shows that Mr. Nicol's estimates were not a "worst case" basis. The evidence shows that the Company is presently receiving less gas than Mr. Nicol's projections.

[6]The evidence shows that this will recover only 50% of the plant costs by 1990 when the presently existing gas supply has been exhausted. The Commission-ordered depreciation rate would recover less than 30% of such costs by that time.

pre-1970 plant. Plaintiff alleges that there can be no logical, or any other kind of reason for having a different depreciation rate for plant placed in service before and after an arbitrarily fixed date.

35. Plaintiff further avers that, even assuming *arguendo* that the proper depreciation rate is an area where regulatory commission expertise comes into play, a commission cannot ignore the *only* evidence of record on the point and arbitrarily set depreciation rates with no statement of its reasons therefor. Plaintiff alleges that such a procedure is a blatant attempt to prevent judicial review of the Commission's action.

IV.

REGULATORY COMMISSION EXPENSE

36. The record, and the Commission's order, reflects that the Staff's witness had used an estimate of $101,500 as regulatory commission expenses to be incurred by the Company in the consolidated proceedings before it. Such estimate had been prepared prior to commencement of the hearings. Toward the end of the hearings, the Staff's witness agreed that the hearings had continued much longer than anyone anticipated.[7] As the result of such fact, the Company requested and was granted the right to file a late-filed exhibit after close of the record showing its regulatory commission

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[7]In this connection, during the first week of the hearings, the press quoted a Commission "official" to the effect that the hearings would conclude "this week." Instead, the hearings commenced on September 3, 1975 and concluded on October 1, 1975.

expenses actually incurred. This the Company did, which showed regulatory commission expenses incurred of $203,420. Included in such amount was $144,000 for outside expert consultants and witnesses.

37. In its order, the first time there had been any indication of a problem with respect to regulatory commission expenses, the Commission characterized these outside expert fees as "exorbitant" and arbitrarily allowed only $100,000 for total regulatory commission expenses, an amount below what its own witness had used and which had admittedly been estimated prior to commencement of the protracted hearings in the proceedings. The Company obviously had no opportunity to meet this issue nor to present evidence as to the reasonableness of the expense incurred. For the reasons set forth hereinafter, the Company alleges that the amount of such expenses was greatly augmented and brought about by the Commission and its Staff.

First. On June 26, 1975, the Company received "Staff's Request No. 1" which with the answers thereto, was later received in evidence as Exhibit H-1. A major portion of this information related to operation of the Company's parent corporation which the Company contended then and still contends was irrelevant to this proceeding (see Section I, Parent-Subsidiary Relationship, *supra*). Most of this data, together with data requested relating to the Company, was not a matter of furnishing data or information already in the possession of the Company, but required special studies to be made in order to put the information in the form and on the bases requested. An examination of Exhibit H-1 will show that it was aimed at having the Company prepare Staff's case for it. The Company estimates that over 2,000 man hours were spent in merely preparing responses to "Staff's Request No. 1". (Exhibit H-1).[8]

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[8]This one exhibit alone exceeds in volume the total of all other exhibits in the case.

Second. In addition, over a period of several weeks, the Staff made oral requests, almost daily, for additional data and information, much of it requiring special studies to be made.

Third. The Commission allowed the Staff to unduly prolong the hearings by exploring in detail, and repetitively, irrelevant operations of the Company's parent as well as the Company's operations. As a result, Plaintiff is advised that the instant proceedings set a new record for number of hearing days before the Commission.

38. Petitioner alleges that, since the Commission and its Staff necessitated the payment of these fees, the denial of recoupment thereof to the Company is an unconstitutional confiscation of the Company s property. Petitioner further alleges that the effect of the Commission's order is to deny a utility the right to adequately present its case to the Commission.

V.

RATE OF RETURN

39. Plaintiff alleges that the only evidence in the record relative to rate of return is that of the Company's expert, Rascon, which showed that the Company required a minimum of 15% return to equity. The Commission's Staff specifically disclaimed making any recommendation on this point. The Commission, without stating any reasoning behind its conclusion other than attacking Mr. Rascon's evidence, allowed 13.5% return to equity.

40. The Commission correctly observed that it was governed on this issue by the landmark *Bluefield*[9] and

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[9]*Bluefield Water Works and Improvement Company v. West Virginia Public Service Commission*, 262 U.S. 679 (1923).

Hope[10] cases of the United States Supreme Court, which held that a regulated entity must be allowed to earn a rate of return comparable to the returns earned by other businesses with corresponding risks and that it should have sufficient earnings to assure the financial integrity of the enterprise and permit it to attract necessary capital–that there be enough revenue, not only for operating expenses, but for the capital costs of doing business.

41. Plaintiff alleges that under the undisputed evidence in this case, in violation of *Bluefield* and *Hope*, "the effect of the Commission's order, considered as a whole," is to deprive the Company of the ability to raise capital necessary to serve the public. In other words, it doesn't matter whether the Commission terms its issues "rate of return,' "depreciation," or whatever it wishes, the effect is the same–the Company under existing and foreseeable economic conditions cannot raise capital necessary to serve the public.

42. Plaintiff alleges that the total effect of the Commission's order here complained of is to deny the Company adequate revenues to enable it to maintain its financial integrity and to attract capital. This is true even if the Company could realize the operating revenues and rate of return to which the Commission found it to be entitled.[11] The operating revenues to which the Commission found the Company to be entitled would provide a debt coverage of only 1.83 times. A gas distribution company cannot raise additional capital with such a low debt coverage and there is no dispute in the evidence as to that. Here again

[10] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

[11] As shown in Sections I and II, *supra*, the Company will not even come close to realizing the revenues to which the Commission found it entitled.

Commissioner Atkins' dissent shows the effect of only one error committed by the Commission (the "imputation" to the Company of net revenues from sales made by Tennessee Natural):

> "...The decision to withhold $1,47,044 less the effect of imputing the revenues, expenses, and investment associated with the three direct customers of Tennessee Natural can only result in Nashville Gas Company not being allowed to charge just and reasonable rates. With the majority's decision to allow only the $1,909,088 the Company will only have the opportunity to earn a rate of return of 10.13%. This was calculated by adding the net operating income of $1,879.935 (excludes effect of rates under bond) shown on page 25 of majority decision to the effect of the rates under bond of $923,082 ($1,909,088 x .48352), for a total of $2,803,017. The $2,803,017 divided by the rate base of $27,657,629 found to be proper in the majority decision indicates the Company will earn a rate of return of 10.13%. The return that will flow to common equity based upon a 10.13% rate of return on rate base is only 8.40%, or 3.41% below the embedded interest cost of 11.812% and 5.10% below the 13.5% found to be fair and reasonable by the majority itself."

43. The uncontroverted evidence of record shows that just to maintain the present distribution system through replacement and to provide for a minimum of system improvements, a capital investment of $7,500,000 over the next five years will be required. Furthermore, the record clearly shows that large additional capital expenditures will be required just to offset supply curtailment. If allowed to stand this order will prevent the company from obtaining these funds, will prevent any measure of growth in meeting future customer needs, and will cause a deterioration of service to the Company's customers.

VI.

METRO FRANCHISE FEE

44. Plaintiff alleges that the proof shows that under the franchise granted to the Company by the Metropolitan Government of Davidson County, Tennessee, the Company is required to pay to such government a franchise fee computed on the basis of 5% of gross revenues. The record shows that: previously, the franchise fee was included in the Company's total cost of service and was thus paid by customers located outside as well as inside Davidson County; the reason such franchise fee was so treated was that the Company lacked the capability to bill the customers located inside and outside of Davidson County separately; the Company has now computerized its billing and has the capability of billing only the customers located in Davidson County for such franchise fee; in the rates filed in Docket No. U-6142, the Company proposed to add a surcharge on the bills of the Company's customers located in Davidson County to cover the 5% franchise fee and thus the rates as filed do not include such fee; during the hearing, neither the Commission nor its Staff indicated any opposition to such treatment, although Staff witness Burcham indicated that there might be some customer confusion and complaints because of the fact that, at that time, it appeared that the Metro Government took the position that such fee is computed on total gross revenues (including the fee itself) so that, although the fee is stated to be 5% of gross revenues, the actual rate to be billed would be 5.263% of gross bill.

45. The Metro Government intervened late in the proceedings before the Commission and took the position that the fee is applied to the gross revenues of the Company from sales to all customers, whether located within or outside of Davidson County and, further, that the gross revenues to be used in computing the fee include not only the fee itself but also the state sales tax, so that the actual rate at which the same would be computed is 5.346%.

46. The Commission, Plaintiff alleges, perhaps as the result of the above-described dispute as to which customers should pay the fee and as to the rate, apparently decided to sidestep the issue; it included the fee in the cost of service *but at a straight 5% rate.* If the Company is compelled to pay on the higher 5.346% rate, it will obviously not be made whole. More importantly, even though the Commission included the franchise fee in the Company's total cost of service, such cost was not included in the rates filed by the Company. As a part of its rate filing, the Company proposed by deliberate design that the rate, plus the proposed franchise fee surcharge, would actually result in little or no increase in total rate to small residential customers and certain classes of commercial customers. If the Court grants the injunctive relief sought herein, allowing the Company to place into effect its proposed rates, but does not allow the Company to add the surcharge for franchise fee as proposed, these customers will receive a reduction in rates, and the Company would not be made whole.

47. Plaintiff avers that since the Company is asking the Court to restrain the Commission from interfering with the Company placing into effect the rates filed in Docket No. U-6142, the Court should specifically provide in its order that the Company shall add as a surcharge the higher 5.346% rate and that the same shall be applied to all the Company's customers, whether located inside or outside Davidson County, under bond subject to refund, pending determination of the issues of what customers should be charged for such fee and the proper rate thereof. In that connection, the Company is not seeking to have the Court determine, in this cause, the proper rate, or to which customers, the franchise fee should be billed.

48. Plaintiff alleges that without the aid of this Court, Plaintiff will be left to suffer daily confiscation of its properties as a result of the unlawful order of the Commission and the unconstitutional effect thereof. Plaintiff avers, therefore, that it has no means of protecting its properties

against confiscation pending the entire future course of this litigation except through the prompt injunctive action of this Court as hereinafter requested.

49. Plaintiff avers that it not only has the right to apply to this Court for a Writ of Certiorari as provided for in T.C.A. 65-220, and because the common law writ of certiorari is always available in such cases, but Plaintiff also has the right to apply to this Court for relief because of the constitutional issues involved and to obtain upon those issues the full, independent judgment of this Court upon both the law and the facts. Plaintiff, therefore, files this as an original bill in equity seeking a review of this Honorable Court on both the law and the facts under the constitutional issues raised herein, and also as a Petition of Certiorari to review the Commission's order of October 14, 1975 in its said Docket No. U-6142.

50. Plaintiff avers that, under the existing law of Tennessee, no provision is made for reimbursement to Plaintiff for the loss it is being compelled by the Commission's order to suffer from day to day, and must continue to suffer unless and until equitable relief is granted by this Court. Plaintiff has no adequate remedy at law to prevent such confiscation and it is suffering, and will continue to suffer, immediate and irreparable injury, as the result of the unlawful and unconstitutional action of the Defendant Commission as set forth in its said order of October 14, 1975. Plaintiff avers that such irreparable loss and injury resulting from day to day confiscation will continue, pending final disposition of this cause and will render such final judgment ineffectual unless Plaintiff is permitted by immediate issuance of a temporary restraining order to arrest the unlawful and unconstitutional confiscation of its properties by restraining the Commission from imposing any penalties or interfering with the collection by Plaintiff of the schedule of rates and charges filed by it on April 14, 1975 in the Commission's Docket No. U-6142, together with a surcharge at the rate of 5.346% to recover the Davidson County Metro franchise fee, heretofore suspended by the Commission. Petitioner avers that

neither the Commission nor the Court has the authority to set rates retroactively and, therefore, in the absence of such extraordinary equitable relief, if the Company's position is ultimately sustained in this cause and the Commission's order declared invalid, a result which must necessarily follow based upon the testimony of the Commission's own witnesses in this cause and the specific findings by the three Commissioners themselves in their deliberative sessions, the Company would have no means by which to recoup the losses sustained by it during the pendency of this litigation.

51. Plaintiff avers that, on the other hand, the Company is ready, able and willing, and hereby expressly offers, to keep appropriate records and to post an adequate surety bond in such amount and terms as may be approved by the Court to insure to its customers adequate and prompt refunds in the event the said order of the Commission dated October 14, 1975, should be adjudicated to be valid at the conclusion of this litigation.

52. Plaintiff avers that, only by granting injunctive relief under such a refunding bond, can both the rights of the Company and its customers be adequately protected. This is the intent and purpose of that provision of T C.A. 65-220(b) which provides that:

> 'In the event that all or any portion of such rates or charges have not been placed into effect under bond before the commission, the court considering an appeal from an order of the commission shall have the power to permit the utility to place all or any part of said rates or charges into effect under bond."

PREMISES CONSIDERED, PLAINTIFF PRAYS:

1. That proper service issue requiring the Defendants to answer this bill within the time required by law

2. That the Court cause the Writ of Certiorari to be forthwith issued to the Defendants requiring them promptly to make, certify, and forward to this Court, a complete record of the transcript and proceedings in this cause, including the transcript of the deliberative sessions of the Commission conducted publicly under the provisions of T.C.A. 8-4401 through 8-4406, and including all of the proof submitted before the Defendant Commission, to the end that all of said proceedings and proof may be fully reviewed and examined by this Court.

3. That all necessary and proper references be had, or additional proof heard as permitted by law, and that this Court declare the effect of the Commission's opinion and order to be confiscatory of Plaintiff's property, not made upon due process, and in violation of Plaintiff s constitutional rights guaranteed to it under Article I, Sections 8 and 21 of the Constitution of the State of Tennessee and the Fifth and Fourteenth Amendments of the Constitution of the United States, and to be in violation of Plaintiff's rights under the statutes of Tennessee; and that the Commission's order of October 14, 1975 be set aside; and, that Plaintiff be afforded all of the rights and protection to which it is entitled under the aforesaid provisions of the state and federal constitutions, under the statutes of Tennessee, and under the general equity powers of the Court, for the purpose of preventing confiscation of Plaintiff's property and affording to Plaintiff such other protection and relief to which it may be entitled; and, that the Court exercise its independent judgment both on the law and the facts to the end that the constitutions may be maintained and Plaintiff's property and rights preserved.

4. That the Court grant an immediate temporary restraining order, in aid of its jurisdiction and to preserve the fruits of the litigation and prevent further confiscation of Plaintiff's property, restraining the Defendants, their agents, representatives and successors in office, from enforcing or attempting to enforce the Commission's aforesaid order of

October 14, 1975, and from penalizing the Company for, or interfering or attempting to interfere with the Company in, putting into effect its tariffs filed April 14, 1975 in the Commission's Docket No. U-6142, together with a surcharge to recoup the Davidson County Metro Franchise fee computed at the rate of 5.346%; such temporary restraining order to be granted, as provided for in T.C.A 65-520(b) and (c), upon condition that the Company file with the Clerk and Master of this Court a bond, in an amount and conditioned as the Court may deem proper, to fully secure and protect the Company's customers for the difference, if any, in the rates provided for in the aforesaid tariffs and the rates which may finally be determined to be just and reasonable.

5. That said temporary restraining order and/or temporary injunction be kept in full force and effect until final disposition of this cause, and that permanent injunctive relief be granted at that time against the enforcement or attempted enforcement of said illegal and unconstitutional order of October 14, 1975.

6. That Plaintiff have such other, further and general relief to which it may be entitled.

THIS IS THE FIRST APPLICATION FOR EXTRAORDINARY PROCESS IN THIS CAUSE.

NASHVILLE GAS COMPANY

By /s/ James C. Cotham III
Vice President

We are surety for the costs
of this cause not to exceed
$500.00.

/s/ John W. Kelley, atty.

BEDWELL & RUDOLPH
502 Madison Building
1155 15th Street, N.W.
Washington, D.C. 20005

By /s/ Wm. W. Bedwell

ORTALE, KELLEY, HERBERT & CRAWFORD
14th Floor, Third National Bank Building
Nashville, Tennessee 37219

By /s/ John W. Kelley

/s/ Leslie B. Enoch, II
Leslie B Enoch, II
814 Church Street
Nashville, Tennessee 37203

ATTORNEYS FOR NASHVILLE GAS COMPANY

STATE OF TENNESSEE)
)
COUNTY OF DAVIDSON)

James C. Cotham, III makes oath that he is Vice President of Nashville Gas Company and that he is authorized to make this verification; that he has read the foregoing bill and petition and the contents thereof are true and correct to the best of his knowledge, information and belief except as to those matters stated upon information and belief, and, as to those matters, he verily believes them to be true.

/s/ James C. Cotham, III

Sworn to and Subscribed before me
on this 1 day of December, 1975.

/s/ Barbara S. Lamb — My Commission Expires:
Notary Public — July 18, 1979

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing pleading has been served on counsel of record in this cause by mailing same to:

Eugene Ward, Esq.
General Counsel
Tennessee Public Service Commission
Cordell Hull Building
Nashville, Tennessee 37219

Tom Midyett, Esq.
Assistant General Counsel
Tennessee Public Service Commission
Cordell Hull Building
Nashville, Tennessee 37219

Larry Woods, Esq. (Attorney for Intervenor, Clifford Allen)
121 17th Avenue, South
Nashville, Tennessee 37203

Milton H. Sitton, Esq. (Attorney for Metropolitan Government)
Legal Department
Metropolitan Courthouse
Nashville, Tennessee 37201

all on this 1st day of December, 1975.

/s/ John W. Kelley

F I A T

TO THE CLERK AND MASTER

Upon the filing of this complaint, notify the defendant(s) that the application for the Temporary Restraining Order prayed for in the foregoing complaint will be heard at 2:30 o'clock P.M., on the 15th day of December, 1975 in Part I of the Chancery Court at Nashville, Tennessee.

This 1st day of December, 1975.

CHANCELLOR

APPENDIX O

BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

Nashville, Tennessee

October 14, 1975

IN RE: PETITION OF NASHVILLE GAS COMPANY TO PLACE INTO EFFECT REVISED NATURAL GAS TARIFFS ESTABLISHING RATES AND CHARGES TO PREVENT MATERIAL IMPAIRMENT OF CREDIT AND FOR EMERGENCY HEARINGS THEREON

DOCKET NO. U-6098

IN RE: PETITION OF NASHVILLE GAS COMPANY TO PLACE INTO EFFECT REVISED NATURAL GAS TARIFFS ESTABLISHING RATES AND CHARGES SO AS TO PERMIT PETITIONER TO EARN A FAIR AND ADEQUATE RATE OF RETURN

DOCKET NO. U-6142

O R D E R

These matters are before the Tennessee Public Service Commission upon the filing by the Nashville Gas Company of petitions to place into effect revised rates for natural gas as set forth in the above captions. Docket U-6098 was filed on January 15, 1975, and Docket U-6142 was filed on April 14, 1975. The combined matters request authority to increase the rates and charges of the company by providing an annual increase in revenues of approximately $6.5 million.

Docket U-6098 was heard by the entire Commission on February 12, 1975, and approximately $1.7 million in annual revenue was permitted to become effective March 13, 1975 under bond subject to refund. Docket U-6098 was consolidated with Docket U-6142 and is now before the

Commission for final disposition.

The exhibits and testimony in support of Docket U-6142 were filed on May 23, 1975. Hearings were held on September 3, 4, 5, 9, 10, 11, 12, 23, 24, 25, 26, 29, and October 1, 1975. The proceedings were heard by Chairman Cayce L. Pentecost, Commissioner Robert N. Clement, and Commissioner Z.D. Atkins, at which time the following appearances were entered:

APPEARANCES:

Mr. W.W. Bedwell, 502 Madison Office Building, 1155 15th Street, N.W., Washington, D.C.; Mr. Leslie B. Enoch, II, Corporate Counsel, 814 Church Street, Nashville, Tennessee; and Mr. John W. Kelley, Attorney, Ortale, Kelley, Herbert and Crawford, 14th Floor, Third National Bank Building, Nashville, Tennessee; all appearing on behalf of the Petitioner.

Mr. Clifford Allen, Mr. Charles Friddell, Mr. Larry Woods, Nashville, Tennessee, appearing as Intervenors and Protestants.

Mr. William F. Howard, Metropolitan Attorney of the Department of Law of the Metropolitan Government of Nashville and Davidson County, appearing on behalf of the Metropolitan Government of Nashville and Davidson County.

Mr. Tom E. Midyett, Jr., Assistant General Counsel, Tennessee Public Service Commission, Nashville, Tennessee, appearing on behalf of the Commission staff.

Nashville Gas Company, a wholly owned subsidiary of Tennessee Natural Gas Lines, Inc., furnishes natural gas to over 62,000 customers in Davidson County and in portions of Sumner, Cheatham, Williamson, and Wilson Counties.

Nashville Gas Company was granted a rate increase by Order dated December 30, 1971, in Docket No. U-5562. On March 13, 1975, in Docket No. U-6098, Nashville Gas Company was granted an emergency rate increase that was placed in effect under bond and subject to refund.

During the course of the hearings the following testified for the Petitioner: W. Crew Anderson, Secretary-Treasurer, Nashville Gas Company; James B. Smith, Assistant Treasurer and Controller, Nashville Gas Company; Arnold A. Horner, Consultant with the firm of H. Zinder and Associates, Inc., of Washington, D.C.; David L. Nicol, Jr., Vice President and Senior Consultant with the firm of H. Zinder and Associates, Inc.; and Michael Rascon, Consultant with the firm of H. Zinder and Associates, Inc.

Whitfield Burcham, Director of the Accounting Division of the Tennessee Public Service Commission, and Dwight Work, Staff Accountant, presented the staff's case.

On October 1, 1975, the Petitioner presented rebuttal testimony through James Smith and David Nicol. Surrebuttal testimony was presented by James Cotham, Vice President of Administration and Customer Services, Nashville Gas Company; Tom Fleming, Director of the Assessment Division, Tennessee Public Service Commission; and Whitfield Burcham.

TEST PERIOD

It is fundamental to the ratemaking process to select the financial experience for a recent period of time (usually one year) to test the company's level of earnings and thus the reasonableness of the present rate structure. The company reflected as a test period the 12 months ended December 31, 1974. The staff used as a test period the 12 months ended June 30, 1975. We will concentrate our discussion upon the issues surrounding the use of each of these test periods.

Company witness Smith, in rebuttal testimony, stated that Nashville Gas Company made a decision to withhold

from filing a rate increase until the entire 1974 operating results had been completed and audited so that the 12 months ended December 31, 1974 could be used as a test period. He stated that although some earlier period of time could have been used as a test period, the company made a decision to delay their filing until the 1974 results had been completed and audited, on the basis that the 1974 results were the best available information and were worth the delay. Witness Smith went on to state that he was in favor of using the latest available information but was opposed to unnecessarily changing the test period. He stated that he felt that the staff's use of a different test period was unreasonable because it only served to confuse the issues. He further stated that he felt that the Commission should use the latest available information but that he did not feel that this was synonymous to using the latest available test period.

Company witness Nicol stated that the latest available information as presented by the staff was not the best information available. He stated that the internal financial statements from which the staff obtained most of its information were not an accurate report of the transactions that occurred during that period of time. He stated that the inherent weakness in the internal financial statements was that neither management nor staff had made the necessary adjustments to obtain a clean cut-off of transactions for the 12 months ended June 30, 1975. He added that since staff used these unverified results, their case could not represent the best information available.

Company witness Horner was questioned on cross examination about the actual firm sales for the first three months of 1975 as reflected in the company's internal financial statements. When asked the question, "And you would assume that the company's internal report data is accurate, would you not?", he responded, "I would."

Staff witness Burcham stated under cross examination that the staff used, as a test period, the 12 months ended

June 30, 1975 because this period of time provided the latest available financial information and in his opinion, the best information, to assist the Commission in making its decision. Witness Burcham stated that the staff had performed certain procedures to verify the reasonableness of the data used in the preparation of the staff's exhibits. Comparative trends of the revenue and expense account balances were studied. He stated that, of the approximately $28,000,000 in total operating expenses after adjustments, $26 500,000 was either verified or derived by staff members.

Staff witness Work stated on cross examination that he felt that his estimate of revenues and sales was a reasonable approximation of what the company could expect to occur in the future.

This Commission has spent considerable time studying the issues dealing with staff's use of a different test period. We feel that the 12 months ended June 30, 1975 is the proper test period to use in this case. We feel that this period of time provides us with the latest and the best financial information upon which to base our final decision.

RATE BASE

One of the primary issues in ratemaking proceedings is the determination of the proper rate base on which the company should earn a rate of return. Both company witness Horner and staff witness Burcham developed end of period rate bases; however, their presentations differed due to the difference in test periods used and the divergent principles followed in arriving at their respective rate bases. Presented below is a comparison of the rate bases presented by the company and the staff:

NASHVILLE GAS COMPANY

COMPARISON OF STAFF AND COMPANY RATE BASES

	Company at Dec. 31, 1974 A/	Staff at June 30, 1975 B/
Gas plant in service	$39,476,033	$39,492,039
Construction work in progress	-0-	293,956
Materials and supplies	203,155	183,109
Cash	697,890	653,806
Prepayments	115,694	-0-
Imprest working funds	17,575	-0-
Total	$40,510,347	$40,622,910
Deductions:		
Accumulated depreciation and amortization	$11,636,405	$11,228,273
Cash advanced for operations by investors	-0-	(80,396)
Accumulated deferred income tax	-0-	1,072,375
Unamortized investment tax credit–Pre 1971	-0-	209,465
Contributions in aid of construction	474,816	490,132
Customer advances for construction	-0-	45,432
Total deductions	$12,111,221	$12,965,281
Rate Base	$28,399,126	$27,657,629

A/ Horner Exhibit AAH-1, Schedule 1.
B/ Burcham Exhibit WB-1, Schedule 2.

Aside from the difference in test periods used, the company's rate base differs from the staff's rate base in the following respects: (1) The company did not include construction work in progress; (2) The company's working capital allowance consisted of cash, prepayments, and imprest working funds, whereas the staff used an average cash amount and the results of a lead-lag study to determine cash advanced for operations by investors; and (3) the staff deducted accumulated deferred income tax, unamortized investment tax credit - Pre 1971, and customer advances for construction, whereas the company did not. At this point, we will discuss the issues concerning the rate bases proposed by the company witness and the staff witness.

Construction Work in Progress

The staff has included the June 30, 1975 balance in construction work in progress of $293,956 in its calculation of rate base and has also included $10,939 of interest capitalized in net operating income. It appears to the Commission from examining the record that the company did not challenge the position of including these two items in the calculation of rate base and income.

The Commission has followed the practice of including plant under construction in the rate base and interest charged construction in net income in recent decisions involving major utilities. It is true that the Commission excluded these two items in calculating the rate base and income in the last rate proceeding involving this company, Docket U-5562. Since that time, however, the Commission has found that for a company with operating circumstances similar to Nashville Gas Company, the inclusion of these items is a realistic approach in determining the reasonableness of the company's rate structure. We believe the practice of including both these items is sound for both the ratepayer and the company, and

accordingly, we include telephone plant charged construction of $293,956 in the development of a rate base and will include interest capitalized of $10,939 in income.

Although the company witness did not include construction work in progress in his development of rate base, he adjusted the year-end plant in service account for non-revenue producing plant additions planned to be in service by October 1, 1975. It is our opinion that the record is unclear as to what Mr. Horner considers to be non-revenue producing plant as opposed to revenue producing plant. The record is clear that Mr. Horner used no studies to determine if the cost of adding revenue producing plant, as he defines it, would be offset by the revenues generated by the new plant. We feel that Mr. Horner has arbitrarily chosen the "non-revenue producing" plant additions from the company's 1975 construction budget in arriving at his adjustment to gas plant in service. It is our opinion that a more reasonable approach would be to include the cost of construction work in progress at year-end in the development of a rate base.

Working Capital

In developing a rate base, staff witness Burcham included two items in working capital: Cash, and Cash advanced for operations by investors. Company witness Horner included cash, prepayments, and imprest working funds in his calculation of the working capital allowance other than materials and supplies. The cash amount used by the company witness represents 45 days' operating expenses less depreciation and taxes.

As a cash amount, witness Burcham used the average cash balance recorded on the company's books for the 12 months ended June 30, 1975. Cash advanced for operations

by investors represents the results of a lead-lag study which measures cash working capital required to finance the day-to-day operations of the company.

The results of the lead-lag study showed that on the average revenues were collected 43.7 days after service was rendered and expenses were paid 42.6 days after service was rendered. The net figure of 1.1 (43.7 less 42.6) means that revenues are collected 1.1 days after expenses are paid. This indicates that the investor has supplied funds to meet the day-to-day expense of providing service. The calculation of the dollar amount of these investor supplied funds was made by multiplying the 1.1 day net interval by the average daily operating funds of $73,087.

In rebuttal testimony, company witness Smith criticized the use of a lead-lag study stating that the study did not recognize the initial investment of working capital that was made by the investor at the time the company began operation. Smith further contended that the 45 day working capital concept used by the company witness would give consideration to the initial investment made by the company's stockholders. However, witness Smith presented no studies on how he would go about quantifying "initial investment" nor did he demonstrate how the 45 day calculation would give effect to the initial investment concept.

This Commission has used the lead-lag study in determining the proper working capital allowance to be used in rate base calculations in the majority of recent major ratemaking proceedings such as this one. During the past three years, the Commission's ruling to accept the lead-lag study as a proper method of computing one of the components of working capital has been challenged twice in Chancery Court. On both instances, the court upheld the Commission's position (*South Central Bell Telephone Company vs.*

Tennessee Public Service Commission, A - 3399, Davidson County Chancery Court, Cantrell Memorandum dated February 5, 1975; and South Central Bell Telephone Company vs. Tennessee Public Service Commission, A-1634, Davidson County Chancery Court, Drowota Memorandum dated March 14, 1973).

After considering all the evidence contained in the record concerning this issue, we find no substantial new arguments advanced which convince us that we should change our position on the working capital issue. We, therefore, adopt the $80,396 cash advanced for operations by investors and the $653,806 cash amount as proper items to be included in the rate base calculation.

Accumulated Deferred Income Tax

The staff deducted, in arriving at its rate base, accumulated deferred income tax resulting from normalizing the tax effect of accelerated depreciation. The company did not deduct this item in its calculation of rate base. In rebuttal testimony, company witness Smith criticized the practice of deducting accumulated deferred income taxes in arriving at rate base adding that, "to exclude that portion of the investment financed by deferred federal income taxes precludes the setting of just and reasonable rates and denies the company any compensation for the risk being taken." According to Smith's testimony, it is the company's position that deferred income taxes have arisen from tax laws "doubling the relationship" between the taxpayer and the United States Treasury and should have no effect on the cost of service the ratepayer should pay.

We feel that the staff has been consistent in its treatment of accumulated deferred income taxes, i.e., to deduct non-investor supplied items of capital in its calculation of rate

base. It is our contention that these funds are customer-supplied, and therefore, the customer should not have to pay a return on capital he himself has contributed. As in the case of working capital, our position on the deferred income tax issue was challenged in Chancery Court. Chancellor Cantrell upheld our decision in his February 5, 1975 Memorandum:

> "The Court merely notes in passing that it appears to be the majority rule that such accumulated deferrals are deducted from the rate base. This seems to be a logical action and one which gives the customer the benefit of the fund of capital arising from the accelerated depreciation."
>
> *South Central Bell Telephone Company vs. Tennessee Public Service Commission*, A-3399, Davidson County Chancery Court, Part I, Page 14.

The Commission has consistently followed the policy of deducting this item in arriving at a rate base for the utilities it regulates, and we can see no justification for departing from this policy in this case. We, therefore, adopt the position that the accumulated deferred income taxes in the amount of $1,072,375 should be deducted in the computation of a rate base.

Unamortized Investment Tax Credit - Pre 1971

Consistent with its position that non-investor supplied items of capital should be deducted in arriving at rate base, the staff deducted unamortized investment tax credit. The company, however, did not deduct this item in arriving at its rate base figure. Based on the facts presented in the record, the company considers the pre-1971 unamortized investment tax credit to be equity capital and should therefore be

reclassified as retained earnings.

This Commission has followed the practice of deducting the balance in the unamortized investment tax credit-Pre 1971 account in determining the rate base in all recent rate cases. Our decision was upheld by Chancellor Cantrell when challenged by South Central Bell Telephone Company. This Commission agrees with staff witness Burcham's position that unamortized investment tax credit - Pre 1971 represents a source of cost-free capital which is supplied to the company by the customer. Therefore, we will deduct the balance of the unamortized investment tax credit - Pre 1971 account of $209,465 in arriving at a rate base for testing the future earnings level.

Customer Advances for Construction

The staff, in calculating a rate base, has deducted $45,432 representing customer advances for construction. This item was not included in the company's rate base calculation. During cross-examination of staff witness Burcham, the company attempted to establish that since these funds are refundable, they should not be deducted as in the case of contributions in aid of construction which are not refundable.

We concur with Mr. Burcham in regarding these funds as customer-supplied capital which should not be included in rate base to allow a return to the company's investors. We would add that this item has traditionally been deducted in the rate base calculation in all recent major rate cases to come before this Commission. We, therefore, adopt the $45,432 customer advances for construction as a proper deduction in calculating rate base.

After carefully considering all the evidence presented on this issue, the Commission adopts the rate base of

$27,657,629 proposed by the staff as being the proper investment on which the company should earn a fair rate of return.

REVENUES

Mr. Horner presented testimony on the cost of service that he felt was appropriate for the test period adopted by the company. He used the actual amounts per books for the 12 months ended December 31, 1974, and adjusted these amounts to arrive at his adjusted cost of service. Mr. Nicol developed rates that would produce the revenue required to approximate the adjusted cost of service as developed by Mr. Horner.

Mr. Work presented testimony on the revenues and purchased gas cost, at June 30, 1975 rates, that he felt the company would have experienced if certain changes that had occurred during the test period had been in effect for the entire test period. Mr. Burcham presented testimony on the rate base and operating expenses other than purchased gas cost which he considered to be reasonable.

Weather Normalization Adjustment

Both the company witness and the staff witness normalized gas sales for warmer than normal weather experienced during their respective test year.

Mr. Horner stated on direct examination that two distinct weather trends had been recorded at the Berry Field Station. The 22 years from 1941-42 through 1962-63 had trended toward colder weather, and the 12 years from 1962-63 through 1973-74, had trended toward warmer weather. Using this observation as a starting point, he assumed that the weather for the year 1975-76 would follow the same

trend as had occurred since 1962-63. He then normalized the actual sales to residential, commercial heating, and low cost housing customers using the linear least squares approach.

Mr. Work used the most recent 30 year degree day deficiency data to normalize firm sales. He computed the average annual degree day deficiency for this period of time and based his normalization upon that amount.

Mr. Horner stated in his supplemental testimony that the 30 year average was less accurate than the linear least squares approach. He stated that he had performed tests in this case as well as other cases to compare the accuracy of the two methods. However, the Commission, in its review and study of the record in this case, has found none of the aforementioned tests entered in support of Mr. Horner's statement.

This Commission is called upon to make a decision on an issue that is surrounded by much debate and uncertainty. We feel that Mr. Horner inherently assumes that weather occurs in cycles. If we are to accept Mr. Horner's theory that the weather for 1975-76 will follow the same trend as established by the actual weather results from 1962-63 through 1973-74, there must be some support in the record concerning the length of weather cycles. We have found none.

This Commission has used the 30 year average for computing weather normalization in prior cases. Specifically, this Commission used the most recent 30 year average for computing weather normalization in the last general rate case involving this company, in Docket No. U-5562 and in the last general rate case involving United Cities Gas Company, in Docket No. U-6096. The issue of weather normalization in Docket No. U-6096 was uncontested. We still feel that the use of the most recent 30 year average to normalize for weather

is appropriate and, therefore, adopt Mr. Work's exhibits concerning this issue.

Growth Adjustment

The next issue upon which this Commission needs to comment is the growth adjustment. Both the company and the staff witness assumed that only the residential class of customers was experiencing any significant growth.

Mr. Work computed his growth adjustment from information obtained in Exhibit H-1, Item 18d, page 2 of 2. In this item the staff had requested from the company the number of new residential, commercial, and industrial customers added from January 1974 through May 1975. The company responded to the request by furnishing the number of new services installed for that period of time.

Mr. Nicol stated on rebuttal that by using the number of new services installed, Mr. Work did not take into consideration the reduction in customers resulting from service line retirements. Therefore, it was Mr. Nicol's contention that Mr. Work's adjustment for growth should be cut approximately in half.

After reviewing the testimony and exhibits regarding this issue, we will accept Mr. Nicol's observation that Mr. Work's growth adjustment should be reduced by approximately 50 percent. Therefore, we will reduce Mr. Work's revenue adjustment due to growth by $42,620.

Reclassification Adjustment

We will now turn our attention to the issue of reclassification. During the 12 months ended June 30, 1975, the company reclassified some 36 customers from an

interruptible classification to a firm classification. Mr. Work made his adjustment for reclassification based on information that he had received from company employees. This information indicated that, as a group, these customers would use approximately 2,100,214 MCF's of gas as firm customers under normal conditions. This total amount of usage equated to the sum of the 36 customers' maximum annual contracted amount of usage.

The company through cross examination attacked Mr. Work's adjustment claiming that he could not have used the maximum annual contracted amounts as an indicator of what these customers could be expected to purchase annually. Mr. Nicol, on rebuttal, stated that the proper indicator would be the actual track records of these customers. He stated, however, that his would be impossible to determine accurately because one would have to take into account not only the volumes purchased, but also the volumes that would have been purchased if there had been no curtailment. Mr. Nicol did sponsor an exhibit indicating his estimate of what these customers could be expected to purchase annually. The amount of gas that these customers would have purchased if there had been no curtailment was estimated. Mr. Nicol's estimate of the volumes these 36 customers would have purchased if they had been firm customers for the entire 12 months ended June 30, 1975, was 1,608,149 MCF's.

There is much discussion in the record concerning the volumes these customers would have used if they had been firm customers for the entire test period. The volumes Mr. Work used in developing his exhibits are estimates. The volumes presented by Mr. Nicol are estimates. We are faced again with making a decision on which estimate best represents what can reasonably be expected to occur in the future. Since Mr. Nicol's estimate is based on the usage for the 12 months ended June 30, 1975, we will accept his

number as being the best estimate of future occurrence.

These customers actually used 893,255 MCF's of gas during the test year after they were converted to a firm classification. If they had been firm customers for the entire test year, they would have used an additional 714,894 MCF's (1,608,149 - 893,255) of firm gas. Multiplying this difference by the revenue per MCF developed from Mr. Work's Exhibit DW-1, Schedule 1, Line 4 gives a revenue adjustment for reclassification of $972,256 (714,894 X $1.36). Therefore, we have reduced Mr. Work's adjustment by $672,011.

Interruptible Sales

We will now discuss the issues surrounding interruptible sales. Mr. Work derived his interruptible sales volumes by developing the volume of gas available to the company and deducting from that company use and unaccounted for, normalized firm sales, reclassified sales, and a volume of gas that the company may not be able to sell due to timing problems and dispatching error. The balance is the gas that is available for interruptible sales.

Mr. Work derived the volume of gas available to the company by using the latest curtailment period quantity entitlement (CPQE) information for the year, November 1, 1975 through October 31, 1976, received by the company from its pipeline supplier. He assumed that the company would be able to purchase 97% of its CPQE plus its allotment from the LNG tank.

Mr. Nicol developed his interruptible sales for the winter curtailment period by assuming that the supply for the winter curtailment period during future years would be the same as the supply authorized during the winter period, November, 1974 through March 1975 He then adjusted his actual

interruptible sales for this winter period to reflect what he felt would be a representative future level of interruptible sales. He developed his interruptible sales for the summer curtailment period by using the CPQE for the period, April 1, 1975 through September 30, 1975. He assumed that the company would be able to purchase 97% of this CPQE. Then he added to this the actual use for the month of October, 1974. Next he subtracted the company's normalized firm use and company use and unaccounted for from the amount to be purchased to determine the amount available for interruptible sales.

Mr. Work has assumed that the company would be able to purchase 97% of the 1975-76 CPQE plus the amount it is entitled to purchase from the LNG tank. Mr. Nicol has assumed that the company would be able to purchase approximately 85% of the 1975-76 CPQE. For the period of time, December 16, 1974, through March 31, 1975, the company actually purchased 98.7% of its CPQE.

The company attempted to prove during cross examination that Mr. Work had made an error in his calculation of interruptible sales. The company implied that Mr. Work had included volumes in both the firm and interruptible sales that had been purchased by the reclassified customers during the time that they were classified as interruptible customers. We have studied the transcripts and exhibits in this case, and we do not find evidence to support this implication.

Therefore, we adopt Mr. Work's interruptible sales volumes and revenues with the adjustments for changes in the growth adjustment and reclassification adjustment that have been discussed earlier. These changes decrease Mr. Work's interruptible volume adjustment by 518,260 MCF's. Multiplying this by the revenue per MCF developed on Line 7

of Exhibit DW-1 Schedule 1, will give us the decrease in Mr. Work's interruptible revenue adjustment of $419,272 (518,260 X $.809).

We will summarize our adjustments to actual test period revenues.

Description	Amounts As Per Exhibit DW-1	Commission Adjustments	Commission as Adjusted
Actual	$26,376,761	——	$26,376,761
Adjustment to eliminate revenue collected under bond from March 13, 1975 through June 30, 1975	(474,029)	——	(474,029)
Adjustment for annualizing PGA increases	2,305,131	——	2,305,131
Adjustment for reclassification of interruptible customers to firm	1,644,267	(672,011)	972,256
Adjustment for growth	85,240	(42,620)	42,620
Adjustment for weather	1,595,466	——	1,595,466
Adjustment to reflect a normal level of interruptible sales	(1,651,105)	419,272	(1,231,833)

TOTAL ADJUSTMENTS	3,504,970	(295,359)	3,209,611
Adjusted Test Period Gas Sales Revenue	$29,881,731	(295,359)	$29,856,372

EXPENSES

We will now turn our attention to a discussion of the various expenses.

Purchased Gas Expense

Mr. Work developed the volume of gas to be purchased by computing the volume of gas available to the company, as per the latest available information from the company's pipeline supplier, and deducting from that the amount of gas the company may not be able to purchase due to timing problems. He then calculated the cost of this gas using the commodity and demand rates at June 30, 1975, and adding to that the actual test period SWS cost and odorization expense, and deducting the cost of gas used for other than utility operations.

Since we have not changed Mr. Work's total sales volumes, we adopt his computation of the cost of gas expense.

Pensions

Both the staff and the company adjusted pension expense to reflect the effects of their respective proforma

salary and wage adjustments. The staff calculated its pension expense adjustment of $127,358 by applying an annual pension accrual rate of 6.5% to the proforma gross salaries and wages of $4,364,830. During cross examination of the staff witness, the company presented evidence that, based on an actuarial study, the company's pension accrual rate should be 7.5% for the next few years.

The Commission agrees with the company that the 7.5% pension accrual rate should be used in the calculation to adjust the pension expense account. We, therefore, adopt an adjustment of $171,006 ($4,364,830 X 7.5% = $327,362 less $156,356 actual pension accrual for test year) as proper to adequately state the pension expense account for ratemaking purposes.

Communications Expense

The company has recorded total communications expense for the period ended June 30, 1975 in the amount of $154,055. The staff made adjustments to reduce the recorded communications expense by $78,235, leaving an adjusted expense of $75,820. In its initial rate filing, the company did not make adjustments to communications expense, however, company witness Horner later agreed during cross-examination by the staff, that it would be proper to adjust his test period's recorded expense of $223,085 downward by $89,141. This would result in an adjusted communications expense of $133,944.

The staff's adjustment was predicated on the theory that by annualizing the actual experience of the first six months of 1975, one would have a reasonable estimate of what the company would expect to expense during the year. The critical point to consider in this hypothesis is whether the first six months experience is representative of one-half of the

year's advertising budget. This point was elaborated on by the company's Vice-President of Administration and Customer Service, James Cotham. Mr. Cotham explained that, normally, spending during the first six months is lighter than the last six months of the year. Therefore, to annualize this six month period and compare that amount to the actual expense recorded during the test year would not be entirely conclusive. Mr. Cotham indicated in his testimony that the $133,944 level of expense would be an appropriate estimate for 1975.

In view of the facts presented on this issue, the Commission feels the $133,944 expense level recommended by the company is appropriate. We, therefore, adopt an adjustment of $20,111 ($154,055 - recorded at June 30, 1975 less $133,944 - expense adopted) as proper to adequately state the communications expense account.

Merchandising - Bad Debts

The staff has made an adjustment to reduce the recorded uncollectible expense associated with merchandising, jobbing, and contract revenue for the test period by $101,059. In his testimony, staff witness Burcham explained that the adjustment was necessary for ratemaking purposes in that it provided for only the uncollectible expense that would be associated with the continuing jobbing and contract work revenues. The staff's adjustment in effect excluded the uncollectible expense relating to the now-defunct merchandising operation, which was discontinued by the company in May of 1974.

During cross examination of company witness Horner, the staff questioned the response furnished them concerning the company's decision to include the entire uncollectible expense balance at December 31, 1974, in the amount of

$73,082 in the cost of service. After questioning by Commission Counsel about the accounting procedures used in the allowance method of recording uncollectibles, witness Horner agreed that the uncollectibles arising from the sale of appliances in prior periods would be taken care of by the provision set up in the year of the sale.

On rebuttal, company witness Smith said the $73,082 uncollectible expense was a proper amount and should be included in the cost of service for the 1974 test year.

We are of the opinion that if proper accounting methods were followed by the company, adequate provisions would have been set up during the years of the appliance charge sales. Therefore, any accounts presumed to be uncollectible and subsequently written off in later years would be theoretically written off against the provision originally set up. It is our opinion that to accept the company's position of retaining the uncollectible expense associated with the discontinued merchandising function would be unreasonable in that it would in essence provide for inadequate provisions set up in prior years. We, therefore, adopt the staff's adjustment as reasonable and proper.

Public Liability Insurance Expense

Staff witness Burcham proposed an adjustment to increase public liability insurance expense in the amount of $62,000. This adjustment represents the additional amount of expense over and above the recorded amount that the company will be required to incur for insurance coverage on the first $100,000 of each loss occurrence. The only issue taken by the company was the allocation of 25% of the cost to the parent company, Tennessee Natural Gas Lines, Inc. During cross-examination of staff witness Burcham, the company contended that the $216,000 quoted premium was

based solely on Nashville Gas Company's loss experience. The company, however, did not disagree that if the insurance was acquired, coverage would be afforded to both the subsidiary and the parent on each public liability claim up to $100,000.

Based on these factors, we feel that the staff's adjustment of $62,000 is proper and should be included in the company's adjusted cost of service.

Regulatory Commission Expense

Both the staff and the company made adjustments to the regulatory commission expense account based on estimates of the cost associated with the emergency interim rate case and the current rate filing. Company witness Horner adjusted the regulatory commission expense upward by $40,000. This adjustment was calculated on a two year amortization of an initial cost estimate of $80 000. Staff witness Burcham's adjustment of $33,833 utilized a three-year amortization period and a revised cost estimate of $101,500 which was furnished the staff during its investigation.

In late filed Exhibit H-33, the company submitted its latest estimate of the cost it expects to incur as a result of this rate case and the emergency interim case heard in March of this year. The estimate furnished was $203,420. Included in this estimate was a $144,000 amount representing consulting services.

Clearly, there are two issues to be decided–the total regulatory expense to be allowed and the amortization period. We are of the opinion that the $203,420 estimate given by the company is exorbitant, especially that of the consultant costs, and should not be borne by the ratepayer. It is our opinion that a proper amount to include in the cost of service of the company for regulatory expense would be $100,000. We feel the costs over and above this amount should be borne by the company's investors.

On the second issue, we feel that an amortization period of less than three years would place an undue burden on the ratepayers. This Commission has traditionally adopted an amortization period within the range of three to five years depending on the circumstances of the particular case. From the record it appears that the company contends that due to conditions unique to the gas industry, primarily supply curtailments, it will be forced to seek rate relief much sooner than the three year period proposed by the staff. If the company should file for a rate increase within the three year period, the unamortized portion of the rate case expense would certainly be taken into consideration and the appropriate amount included in the company's cost of service.

We, therefore, adopt the three year amortization period proposed by the staff and a total regulatory cost amount of $100,000. Thus, we consider a proper adjustment to the regulatory commission expense account to be $33,333 ($100,000 ÷ 3).

Depreciation

Mr. Nicol presented testimony concerning the proper depreciation rate that should be adopted by this Commission. From a study based on exhausting gas supply, he developed a depreciation rate of 9.58%. Mr. Nicol, however, recommended 6.11%, or approximately halfway between the present rate of 2.5% and his computed rate of 9.58%. The staff did not present testimony concerning the proper depreciation rates that the Commission should adopt.

While the Commission feels it can properly take into account the possible exhaustion of supplies in determining whether an increase in depreciation rates is justified, its decision must be significantly supported by factual evidence of the relationship of declining supplies and the useful life of the particular property at issue. The Commission would be obligated to make an affirmative finding that the exhaustion of supplies had caused the useful life of the particular property to be reduced to the extent that physical life (of less

expense to consumers) was no longer an appropriate measure of useful life. The substitution of a higher economic life based depreciation rate for a lower physical life based rate would necessarily increase gas prices to current consumers.

This Commission is obligated to ascertain the useful life of the property of the Nashville Gas Company. In this case this Commission can look to the recent decision of the United States Court of Appeals for the District of Columbia Circuit in the case of *Memphis Light, Gas & Water Division vs. Federal Power Commission,* et al, Case No. 73-1506, September 3, 1974, in which the depreciation rate authorized by the Federal Power Commission in a United Gas Pipeline Company proceeding was challenged by Memphis. In its presentation before the Federal Power Commission, United's depreciation witness took the same position as Mr. Nicol in this case. The United witness testified that United would cease doing business as a transmission company in 1990 because of declining gas reserves. The court found that since United's depreciation exhibits were not based upon any forecast or prediction of future reserves which actually may be expected to be added to United's system and that since no United witness testified that termination of business in 1990 was even the remotest possibility, depreciation rates based upon such information were improper and the case was remanded to the Federal Power Commission for further consideration. The Court found:

> "The Commission cannot indulge the utility in an abstract projection which is premised on termination of service and which amounts to a 'worse case' analysis."

Mr. Nicol, under cross-examination regarding the physical life of the property, stated: "The property of this company and most pipelines will probably last for 200 years, given proper maintenance." He also stated that he felt interim replacements will have a physical life far in excess of the economic life. The witness was asked if "...it is the gas supply

that is determinative of the end point of the remaining life of the Nashville Gas plant?" To this he answered "That is one of the factors in this matter, and to a degree, I have not reflected any of the mortality studies in the ultimate retirement of the property. It is probably the only factor that causes the plant to be fully depreciated by 1990."

Mr. Nicol stated that he felt "that depreciation should be bottomed on known conditions." He also stated that Tennessee Gas Pipeline has been acquiring new supplies, and that, as the new supplies are acquired, they should be added to the amounts shown in his exhibits. He stated that he did not include in his exhibits any volumes other than those presently contracted for, nor did he include any volumes of gas from the intrastate market or gas supplies proven but not committed.

Mr. Nicol stated that although he had some knowledge of the company's increased activity in searching for some new supplies of gas including its activity within the State of Tennessee, he had not used this in his study because he could not quantify the potential available to them. He also admitted knowledge that the company had in the past served with manufactured gas and agreed that from an engineering feasibility standpoint it was still possible to serve manufactured gas using the same lines, meters, and service lines used today. However, he stated that he did not consider synthetic material gas or manufactured gas as economically feasible and, therefore, had not used this as a future source in his study.

Mr. Nicol stated that he was not saying that the Nashville Gas Company was going to close its doors and go out of business in 1990. He stated that there would be some additional gas supply located, and this additional supply would allow the company to continue in business. He also explained that "...as volumes are produced from its reserves, the deliverability reduces to the point where it cannot maintain deliveries at the present level. So, there is a

continual decline in the gas deliveries, and the actual gas will take many years to be produced."

Mr. Anderson testified that supplemental gas supplies coming on line from various sources should reverse the downward trend of gas supply about 1980.

It becomes apparent that what is actually being predicted is not a system which is likely to have an increasingly declining utilization over the years, but one in which there may be a period of declining supply to some indefinite degree, but which, as a system, would be capable of handling the same or greater volumes in later years as increasing quantities of conventional and unconventional supplies of gas become available. To include only gas supplies under contract from the natural gas pipeline is to accept arbitrary "worse case" assumptions, not founded upon sufficient factual support as to the effect of current gas shortage and possible future gas supplements on the remaining serviceable life of the company's facilities. This could result in unnecessary subsidization of future customers by present ratepayers and could well serve simply to provide an unwarranted present windfall to the company along with a parallel subsidy to future customers at the expense of overburdening present customers. Thus, the depreciation exhibits are not based upon any forecast or prediction of future reserves which actually may be expected to be added to the suppliers system.

The Commission feels that before an established depreciation rate can be found to be inadequate due to alleged depletion of supplies, there must be a reasoned appraisal as to future reserves and the impact of such reserves upon the utilization of specific facilities. No Nashville Gas Company witness testified that termination of business was even the remotest possibility and it is not even argued that Nashville Gas Company will terminate gas operations. The record contains no evidence that any of the Nashville Gas Company's property will be abandoned prior to the exhaustion of its physical life if more natural gas from

conventional or nonconventional sources becomes available. Mr. Nicol testified that no retirements will begin until facilities are no longer useful and that no retirements or permanent removals would be made if more gas is available. Mr. Nicol testified that: "Any changes that occur in the supply picture or the marketing policy, or for that matter, the inflation rate, would certainly affect the whole project."

The Commission must take into account current Commission policies designed to increase or to sustain industry-wide gas supply. It must also take into account current Federal Power Commission policies designed to increase or to sustain industry-wide gas supply. The record indicates that sales volumes are increasing at the present time and that Nashville Gas is still in position to add selectively to its residential customers and commercial customers on a replacement basis where no substantial investment is required. Even if sales should fail to increase, this cannot support an inference that the useful life of the company's property has lessened. The record indicates and the Commission must take into account the high priority of 89% of Nashville Gas Company's volumes. In considering the gas supply, the Commission must consider the record which indicates the strong overall reserve strength of Tennessee Gas Pipeline Company, a Division of Tenneco, as the sole supplier of Tennessee Natural Gas Lines, Inc., which is the sole supplier of Nashville Gas Company and the aggressive program for finding new sources of pipeline quality gas from both conventional and nonconventional sources.

This Commission recognizes that there is uncertainty in the area of gas supply and that there will in fact be a decreasing gas supply in the next few years until supplemental supplies become available. In recognition of these factors, it appears that a change from the present 2.5% depreciation rate of the Nashville Gas Company is warranted. We feel that a depreciation rate of 4% on all additions since January 1, 1970 would give appropriate recognition to these factors, while not causing an unreasonable burden on existing customers. We feel

that a 2.5% depreciation rate should remain in effect on all plant in service prior to January 1, 1970.

This new depreciation rate determination will result in an upward adjustment to the depreciation expense account of $193,333. The Commission has calculated the depreciation expense adjustment from information contained in the company's annual reports filed with this Commission for the years 1970 through 1974. In order to consider additions between December 31, 1974 and June 30, 1975, the Commission has utilized the internal monthly reports of the company. Based on these documents, the Commission has calculated that the 4% depreciation rate would produce depreciation expense in the amount of $515,554 on the additions after January 1, 1970. These additions in the amount of $12,888,838 were calculated by adding the recorded retirements since December 31, 1969, of $642,730 to the net additions recorded during the same period in the amount of $12,246,108. The 2.5% rate was then applied to the depreciable plant (other than transportation equipment) on the books at December 31, 1969, less the retirements recorded from January 1, 1970 to June 30, 1975, to arrive at a depreciation expense applicable to pre-1970 depreciable plant in the amount of $627,495. The calculated depreciation expense of $1,143,049 ($515,554 + $627,495) was netted against the depreciation expense on all property other than transportation equipment recorded as of June 30, 1975, in the amount of $949,716 to arrive at the $193,333 adjustment.

Property Tax

Both the company and the staff presented property tax adjustments in this case. The $315,747 adjustment made by company witness Horner assumed that the property tax assessment was based on gross book cost of plant. It is evident from the record that the Assessment Division of this Commission uses net book cost of plant as the cost indicator of value in determining the regulated utilities property tax

assessment.

The staff calculated an adjustment for its test year in the amount of $60,348. In his direct testimony, staff witness Burcham explained that in arriving at his adjustment he applied the actual 1975 tax rates to the 1975 assessment of $15,400,000 furnished him by Mr. Tom Fleming, Director of the Assessment Division, to come up with a reasonable estimate of what the company could expect to pay in Ad Valorem tax in 1975.

The company took issue with the staff's adjustment, contending that the $15,400,000 assessment did not reflect the company's future earnings it could expect under rates approved in this rate filing. This, however, was rebutted by staff witness Fleming, who indicated his division did take future earnings into account in its determination of the proper assessment.

From the facts presented on this issue, we are of the opinion that the 1975 assessment is proper and that the staff's adjustment of $69,348 is just and reasonable.

Other Operating Taxes

Due to the revenue adjustment adopted by this Commission, operating taxes should also be adjusted to take into account the revised revenue base. Since the Commission has adopted the staff's June 30, 1975 test year, the adjusted operating taxes should be reduced by the appropriate amount relating to the difference in the adjusted revenue proposed by the staff and that adopted by this Commission. The gas sales revenue proposed by the staff was $29,881,731. The Commission has adopted gas sales revenue under present rates of $29,586,372. Therefore, taxes should be reduced by the applicable percentage of the $295,359 difference ($29,881,731 - $29,586,372).

This would result in the following downward adjustments to the staff's proposed taxes:

State gross receipts, franchise, and excise taxes (1.5%)	$ 4,430
Nashville franchise fee (5%)	14,768
Public Service Commission fee (.075%)	222

We, therefore, adopt the following tax expense amounts as proper: State gross receipts, franchise, and excise taxes - $449,635; Nashville franchise fee - $1,479,319; and Public Service Commission fee and other taxes - $25,361.

The following is the income statement adopted by this Commission based on the findings in this Order :

		WB-1, Sch. 3 June 30, 1975	Adjustments	Commission As Adjusted
1.	Gas sales revenues	$29,881,731	$(295,359)	$29,586,372
2.	Forfeited discounts	317,157	-0-	317,157
3.	Other gas revenue	72,107	-0-	72,107
4.	Interest capitalized	10,939	-0-	10,939
5.	Total operating revenues	$30,281,934	$(295,359)	$29,986,575
	Operating expenses:			
6.	Cost of gas sold	$17,977,860	-0-	$17,977,860
7.	Other operation & maintenance	5,655,896	101,272	5,757,168
8.	Depreciation and amortization	991,250	175,102	1,166,352
9.	Contributions	23,924	-0-	23,924
	Taxes other than income:			
10.	Ad Valorem	806,055	-0-	806,055
11.	State gross receipts, franchise, and excise tax	454,065	(4,430)	449,635
12.	Nashville franchise fee	1,494,087	(14,768)	1,479,319
13.	Payroll taxes	198,295	-0-	198,295
14.	PSC fee and other taxes	25,583	(222)	25,361
15.	Federal income tax	487,781	(265,110)	222,671
16.	Total Operating expenses	$28,114,796	$ (8,156)	$28,106,640
17.	Net operating income (L5 - L16)	$ 2,167,138	$(287,203)	$ 1,879,935

Federal Income Tax

As a result of the previously discussed revenue and expense adjustments, federal income tax expense should be revised to give effect to the change in taxable income.

The following is a calculation of the federal income tax expense adopted by the Commission:

Revenue adjustment		$(295,359)
Expense adjustments:		
Other operations & maintenance	$101,272	
Depreciation and amortization	175,102	
Other operating taxes	(19,420)	256,954
Effect on taxable income		$(552,313)
Tax rate		x 48%
Effect on federal income taxes		$(265,110)

RATE DESIGN

The Commission agrees with the company s proposal that there should be no increase placed on the residential customers. The Commission also adopts the company's proposal to reduce the late payment charge from 10% of the net bill to 5%.

FAIR RATE OF RETURN

A finding on fair rate of return is one of the most subjective determinations the Commission must make in arriving at a decision concerning the proper level of rates for the company to charge its customers. We have the duty to make this determination based upon the controlling legal standards laid down in the landmark *Bluefield* and *Hope* cases. In the *Bluefield* case, the Supreme Court stated that, "A regulated entity must be allowed to earn a rate of return

comparable to the returns earned by other businesses with corresponding risks and uncertainties and that the allowance should provide sufficient earnings to assure the financial integrity of the enterprise and permit it to attract necessary capital." (*Bluefield Water Works and Improvement Company vs. West Virginia Public Service Commission, 262, US 679*). Later in the *Hope* case, the Court refined these guidelines, holding that from the investor point of view "it is important that there be enough revenue, not only for operating expenses, but for the capital cost of doing business." (*Federal Power Commission vs. Hope Natural Gas, 320, US 591*). With these basic standards in mind, we will now discuss some of the important considerations that were presented in the record on the subject of fair rate of return. We believe that such standards as set out in these two decisions point up an important fact that the setting of a fair rate of return is not an exact science. A return that one informed person believes is fair and necessary to provide a comparable return enjoyed by other similar enterprises and to attract necessary capital, may not be the same return as another informed person might believe.

Needless to say, our discussion of necessity is limited and cannot and will not be fully comprehensive of all relevant matters and components that go into the make-up of the determination of a fair rate of return.

Mr. Michael Rascon, Public Utilities Consultant with the firm of H. Zinder and Associates, Inc., of Washington, D.C., testified on behalf of the company on the subject of fair rate of return. In conjunction with his testimony, Mr. Rascon presented Exhibit MR-1, consisting of 31 schedules. On Schedule 31 Mr. Rascon presented the company's capital structure as of December 31, 1974, with certain revisions to reflect changes after the close of 1974 that would have a material effect upon the company's capital structure and cost of capital. Shown below is a table of the company's capital structure summarizing Mr. Rascon's Schedule 31 and the revisions he made during his testimony on September 10, 1975:

Class of Capital	Amount Outstanding	Percent of Total Capital	Effective Cost Rate	Weighted Average Cost of Capital
Long term debt:				
First Mortgage Bond	$10,000,000	37.42%	12.800%	4.790%
Bank Term Loans	5,000,000	18.71%	9.835%	1.840%
Total	$15,000,000	56.13%	11.812%	6.630%
Preferred Stock	1,215,000	4.55%	4.500%	.205%
Stockholder's Equity	10,507,099	39.32%	15.000%	5.898%
Total	$26,722,099	100.00%		12.733%

Debt Capital

The cost of debt is generally not a controversial issue and can usually be readily determined. The table above shows the cost of first mortgage bonds to be 12.800%. Initially it was estimated that the cost of these bonds would be 12.614% because the sale of the bonds had not been completed when Mr. Rascon filed his testimony, he assumed that the sales expense would be $90,000. During his testimony on September 10, 1975, Mr. Rascon testified that the cost of selling the bonds at that time was $150,000 and that he felt that a 12.8% cost rate should be used as the cost of the first mortgage bonds. We will adopt the 12.8% cost rate proposed by Mr. Rascon.

Mr. Rascon reflects a cost rate of 9.835% for bank term loans which was an average of the interest rates paid for 1974. We feel that the use of the average is the appropriate cost rate to use due to the unstable nature of interest rates and will adopt the 9.835% used by Mr. Rascon.

Preferred Stock

The preferred stock, unlike common stock, has an assigned cost rate of 4.5% and comprises 4.55% of the capital structure as shown on Mr. Rascon's Schedule 31. We will adopt the cost rate of 4.5% used by Mr. Rascon for preferred stock.

Stockholder's Equity

The cost of equity is a subjective factor and cannot be determined by a precise mathematical formula. A determination of the cost of equity capital requires the application of informed judgment. Mr. Rascon has recommended a 15% return to common equity. The Commission will analyze herein the testimony and exhibits presented by Mr. Rascon in determining what he considered to be a fair return on common equity.

Mr. Rascon stated that he followed the principles laid down in the *Hope* and *Bluefield* cases, previously discussed, to guide him in his determination of a fair rate of return. At the outset of his testimony Mr. Rascon cited various excerpts from the *Hope* and *Bluefield* cases and then cited what he thought a fair rate of return should encompass. To summarize, Mr. Rascon said that the projected fair rate of return should: (1) Reflect the current money market and business conditions in general, (2) Be at a level so as to provide adequately for all costs of capital, (3) Approach equality with returns on investments in other enterprises having corresponding risks, (4) Be at a level which will maintain the financial integrity and credit of the enterprise, and (5) Be at a level which will enable the enterprise to attract additional capital on favorable terms.

When asked what methodology he utilized for the determination of the projected fair rate of return, Mr. Rascon replied that he used the "so-called comparable earnings method and its corollary, the capital attraction standard." It

appeared to the Commission that the earnings standard or the alternative opportunity cost standard, as Mr. Rascon called it, was one of the more important factors relied upon by Mr. Rascon. In his prepared testimony, Mr. Rascon stated that he had chosen 69 companies that he thought were comparable to Nashville Gas Company. He stated that he had chosen the 69 comparable companies from a group of 190 companies, both regulated and unregulated, based on a six item criteria which he later corrected to a five item criteria. Commission counsel Midyett pointed out on cross examination that two of the five listed criteria were identical leaving in reality, only three criteria to use to select his comparable companies, which were as follows:

(1) Include all companies with outstanding and actively traded most senior securities bearing the identical rating classification as the subject company.

(2) Include all companies for which comparable year-to-year financial data are available for seven years.

(3) Include all companies without outstanding and actively traded common stock with a rating classification of B+."

Going now to his first criterion, Mr. Rascon stated that he chose enterprises with a Moody's rating on their most senior long term securities identical to Nashville Gas Company's assigned rating. That rating, according to Mr. Rascon, was Baa, which he said was Nashville Gas Company's prevailing rating in August of 1974. Mr. Rascon stated that he concluded that all enterprises with a Moody's assigned rating of Baa on their more senior securities constituted a proper universe of "available alternative investment opportunities" to Nashville Gas Company.

On cross-examination, Mr. Midyett asked Mr. Rascon if

in effect what he was saying was that any enterprise with a Moody's Baa bond rating was comparable to Nashville Gas Company. He replied, no, that he meant that the risk was comparable because the rating goes to the risk factor attending the more senior securities. The Commission is at a loss to distinguish between the terminology which Mr. Rascon uses. He said that the "comparable earnings approach" is also often expressed as the "alternative opportunity cost standard", and later he said that enterprises with a Moody's Baa rating constituted a proper universe of "available alternative investment opportunities". But he stated that because companies were "available alternative investment opportunities", did not mean that they were comparable. It is difficult for the Commission to discern a difference in "available alternative investment opportunities" and "alternative opportunity cost standard".

In support of his use of bond ratings, Mr. Rascon testified that Moody's conducts an exhaustive analysis of some 29 factors which go into the determination of the degree of protection and security of the principal and interest that a utility can offer before rating an issue. Mr. Rascon did not elaborate as to what those factors were. In his prepared testimony Mr. Rascon was discussing comparative statistics shown on his Schedule 23, using 18 of his 37 utility companies and 16 of the 32 industrial and other companies. When asked why he had excluded approximately half of his comparable companies for this purpose, Mr. Rascon responded that he had listed all of the companies' returns on equity on Schedules 25 and 27, and that the ones excluded were excluded because their earnings on average common equity were less than 10.0%. He concluded that companies earning less than 10.0% on equity would not be Nashville Gas Company's next best competitor for the investor's dollars. On cross-examination Mr. Midyett pointed out that the comparable companies dismissed by Mr. Rascon from consideration were rated Baa by Moody's according to his criterion, but he felt it proper to ignore them.

We find it at best confusing to understand why a witness would put such great weight and reliance upon Moody's to compare the risks of companies through bond ratings and yet dismiss half of the companies as not being the next best competitors for the investors' dollars because they earned less than 10.0% on equity. It seems to point up either one of two possible conclusions, that (1) Moody's assignment of Baa ratings to companies with returns on average common equity of 4.36% to 33.75% leaves something to be desired, or that (2) the comparable bond ratings are a good tool until you get to a return on equity; then one must pick and choose.

Mr. Rascon stated that he used the second criterion of comparable data for seven years to make various industry group-utility group comparisons shown on his Schedules 20-23. His use of this criterion in Schedules 25 and 27 was to select companies that he could compile for six year average statistics, such as the returns on equity and equity ratios from 1968 to 1973.

The third criterion used was the inclusion in Schedules 25 and 27 of the companies that had actively traded common stock rated B+. It was pointed out on cross-examination that Nashville Gas Company's stock is not traded, and Mr. Rascon explained that he used the B+ rating because "it was an average rating for an average industrial common stock." When asked if B+ was an average rating for a regulated gas distribution company, he responded that he did not know, and when asked if he had checked on an average rating for such a utility, he replied that he had not.

Schedules 25 and 27 mentioned earlier show the rates of return on average common equity and average common equity ratios for Mr. Rascon's 37 comparable utilities and his 32 comparable industrial enterprises for the years 1968 through 1973. The utilities include gas, electric, and telephone companies with Baa bond ratings and predominately B+ common stock ratings. Earnings on common equity ranged from 5.02% for Blackstone Valley Electric to 21.74% for

Mississippi River Transmission Corporation in 1973. The first 19 of the 37 utilities' average earnings on common equity in 1968-1973 were 9.96%, 8.76%, 9.58%, 9.43%, 10.05%, and 9.05%, respectively. The next 9 upper companies earned 12.37%, 12.05%, 12.56%, 12.60%, 12.61%, and 12.41% from 1968-1973, respectively, and the upper most 9 companies earned 18.10%, 15.80%, 16.04%, 16.30%, 15.78%, and 15.69% from 1968-1973, respectively.

Schedule 27 included 32 industrial and other enterprises including retail store chains, freight companies, distilleries, clothing manufacturers, railroad companies, etc. There was a wide variety of companies. Mr. Rascon pointed out that the *Hope* and *Bluefield* cases called for comparable earnings for companies having corresponding risks, and he allowed the Moody's rating agency to measure all the risks for him through the Baa bond ratings. It appears to the Commission that retail stores, manufacturers, etc., would have somewhat different risks than regulated industries in that while they are more flexible to cost increases through raising prices without regulatory approval, they also have stiff competition in the market place, while regulated industries have little or no competition.

The returns on average common equity in 1973 on Schedule 27 ranged from 4.36% for Phillips Industries, Inc., to 33.75% for Amerada Hess Corporation. The returns on average common equity of all the enterprises on Schedule 27 for the first 16 companies were 8.51%, 8.57%, 5.61%, 6.68%, 7.25%, and 8.17% from 1968-1973, respectively. For the next 8 companies the returns were 12.18%, 11.97%, 9.41%, 10.30%, 10.54%, and 11.49% for the 1968-1973 period, respectively. The upper most 8 companies returns were 21.21%, 18.94%, 14.88%, 16.28%, 15.70%, and 18.76% from 1968-1973, respectively.

Mr. Rascon concluded, after reviewing Schedules 25 and 27, that a return to common equity of not less than 15% was reasonable for Nashville Gas Company to earn.

In reviewing these two schedules the Commission feels that as only 4 to 6 companies generally averaged returns of 15% or more, it is hard to understand why Mr. Rascon could draw such a conclusion. If he had used the first 18 or first 16 companies from each schedule, he could have recommended a rate of return of 8 to 9%; using the next 9 and next 8 companies from each schedule he could have recommended a return of 10.5% to 12.5%, but he apparently weighed his decision heavily upon the last 9 and last 8 companies from each schedule to arrive at a return of not less than 15% on common equity.

After considering all of the evidence in the record concerning the fair rate of return to common equity and examining the force of reasoning of Mr. Rascon, we feel that a return to common equity of 13.5% would be fair and reasonable and in keeping with principles laid down in the *Hope* and *Bluefield* decisions previously discussed.

Applying a 13.5% cost rate to Mr. Rascon's capital structure, as summarized in the table previously presented in our discussion, indicates a need for a 12.14% rate of return on rate base.

ADDITIONAL REVENUE REQUIREMENTS

A 12.14% rate of return applied to the rate base of $27,657,629 found proper in this Order, indicates a need for net operating income of $3,357,636. The net operating income allowed of $3,357,636 is $1,477,701 more than the adjusted test period net operating income of $1,879,935, indicating a need to increase net operating income of $1,477,701.

Following is a computation of the retention factor which represents the percent of net revenue retained resulting from an increase in one dollar of revenue.

Base		1.0000
Tennessee gross receipts	.01500	
Metro franchise fee	.05000	
TPSC Inspection fee	.00075	
Uncollectible factor	.00440	.07015
		.92985
Federal income tax (.92985 x 48%)		.44633
Balance		.48352

Now that the Commission has determined the additional net revenue required, we must now determine the additional gross revenue requirements. Based on the above retention factor, for each $1,000 increase in gross revenue, $483.52 will flow to net operating income. Thus, it will require $3,056,132 ($1,477,701 ÷ .48352) in gross revenues to produce a net operating income amount of $1,477,701. Since the company has rates under bond that will produce gross revenues of $1,909,088, this would require an additional $1,147,044 in gross revenues over the bonded revenues.

PARENT-SUBSIDIARY RELATIONSHIP

There is one other matter which concerns this Commission greatly and which has been discussed at great length in this record–that is, the relationship between the Nashville Gas Company and its parent, the Tennessee Natural Gas Lines, Inc.

The most frequent and controversial issue raised during the course of the proceedings related to Tennessee Natural Gas Lines, Inc., serving three large industrial customers (E.I. DuPont de Nemours, Ford Motor Company, and Armstrong Tire and Rubber Company) located within the certificated area of Nashville Gas Company. The questions posed are:

(1) Why did Nashville Gas Company not serve these customers,

(2) Why did it not object to its parent serving customers located within its certificated area, and

(3) If Nashville Gas had served these customers, how would it have affected its rates?

Before discussing these questions, an understanding should be had about the operation of the parent, Tennessee Natural Gas Lines, Inc. The record shows that it owns 100% of the outstanding stock of Nashville Gas Company. In addition, it has invested funds to serve four customers (Nashville Gas and the three direct customers). The rates charged by Tennessee Natural Gas Lines, Inc., to Nashville Gas Company are regulated by the FPC, and the rates charged the three industrial customers are not regulated by the FPC, but are negotiated by Tennessee Natural with the three customers. The profits realized on that portion of Tennessee Natural's investment related to Nashville Gas Company is regulated by the FPC, but the profits realized on the other three customers are not regulated by the FPC.

We will now discuss the first of the three questions enumerated above, i.e., why did Nashville Gas Company not serve the three customers; located within its certificated area? This question was presented to the company in an interrogatory identified as Exhibit H-1, Item 40(d)(4). The company provided a 5-page response. The essence of that response was that, in the first place, these customers were not located in Nashville's franchise area at the time Tennessee Natural started serving these customers, and that even if the customers had been located within Nashville's franchise area, Nashville Gas Company did not have the ability to raise the necessary capital to serve these customers. The company interprets its "franchise with the City of Nashville" as being synonymous to the area certificated by this Commission. The

record indicates that the Nashville Gas Company had a certificate to provide service in "Nashville and its environs". So it seems that the argument that these customers were not located within the certificated area is not sound.

The other argument was that Nashville Gas Company did not have the capability to raise the necessary capital to serve these customers, even if they could have been served by Nashville Gas Company. The present record shows that Nashville recently borrowed $10,000,000 and the parent acted as surety. It seems logical to us to believe that a similar sets of terms could have been worked out to serve these customers if it was such that Nashville Gas Company could not have raised the money to serve these customers on the basis of its own financial strength.

The second question posed was, why did Nashville Gas Company not object to its parent serving these three customers located within its certificated territory? It was disclosed that Mr. Wister Ligon immediate past President of Nashville Gas Company, was asked the following hypothetical questions and gave the following answer in regard to someone other than the parent serving customers located within the certificated area of Nashville Gas Company?

> "Q Mr. Ligon, in your direct testimony you generally defined the area which is served by the Nashville Gas Company, and you indicated it has been serving this area for a considerable length of time. Is it true, or it is true, is it not, that Tennessee Natural Gas Lines, the parent of Nashville Gas Company, is serving certain industrial customers within your certificated area, specifically DuPont, Ford, and Gates Rubber Company?
>
> A That is true.
>
> . . . . .

> Q Mr. Ligon, in your position as President of Nashville Gas Company, give you a hypothetical question, if I might, please, sir. If the United Cities Gas Company, with which I am sure you are familiar, were to come into your certificated area and attempt to solicit as a customer some industry which is located within your certificated area, would your company object to this practice?
>
> A Yes, we would.
>
> Q Did your company, to your knowledge, that is, did the Nashville Gas and Heating Company, object to Tennessee Natural Gas when it began serving the aforementioned customers within your certificated area?
>
> A We did not. Tennessee Natural Gas had the facilities and had the supply at that time. This goes back a number of years, as you know They have a large capacity gas line. They had the facilities to serve and it was necessary for us to do this."
>
> (Volume I, Page 70, Docket U-5562)

In this record, Mr. Crew Anderson, Treasurer, also testified that Nashville Gas Company would object to another company coming into its service area. It seems reasonable to us to expect Nashville Gas to apply the same standard to its parent as it would if it were dealing at arm's length.

The third question relates to how would Nashville Gas Company have been affected if it had served these customers instead of its parent. The record shows that from 1969 to 1973, Tennessee Natural Gas Lines made in the neighborhood of a 50% rate of return on its total investment. The record also shows that the FPC had approved rates of return of

approximately 9% on that portion of Tennessee Natural's investment that it regulates. It would necessarily follow that the extremely high rates of return result from the sales to the three industrial customers. If these customers were served by Nashville Gas Company, it is clear that it would reduce the need to increase Nashville Gas Company's rates as much as has been heretofore found necessary by our previous findings in this Order.

Nashville Gas Company refused to furnish information pertaining to the three industrial customers, stating:

> "Nashville Gas Company respectfully objects to responding to this question and to preparing Attachment M. Tennessee Natural Gas Lines' rate of return is regulated and established by the Federal Power Commission pursuant to Section 4 and 5 of the Natural Gas Act and it has no relevance or materiality to this proceeding."

We believe this information is material and necessary if we are to meet our statutory responsibility of setting just and reasonable rates for Nashville Gas Company. It is our position that the Nashville Gas Company should have acted towards its parent as it would have to an outside company when the decision was made by Tennessee Natural Gas Lines to serve these three customers located within the certificated area of Nashville Gas. A policy of selecting profitable customers by the parent and less profitable customers by Nashville Gas Company cannot result in the setting of just and reasonable rates for Nashville Gas Company *unless* and *until* the Commission has sufficient information to determine what rates would be required by Nashville Gas Company if it, instead of its parent, were serving these three customers.

Through utilization of information contained in Exhibits H-1 and H-27, it can be seen that Tennessee Natural realized a net operating income in 1974 of $1,434,467. It can also be observed from information contained in these exhibits that

the FPC has approved net operating income to be earned on the investments of the portion of Tennessee Natural that it regulates of approximately $762,000, leaving $672,467 which would be applicable to operations other than that regulated by the FPC. The investment associated with the transmission facilities in service Nashville Gas Company and the three industrial customers is approximately $1,000,000. A net operating income of $672,467, and a resulting rate of return of over 60% is clearly excessive. We are not saying this information is sufficiently accurate as a basis for establishing future rates. We do, however, believe this serves as a useful guide in assessing the possible impact on Nashville Gas Company's operations if these customers had been served by Nashville Gas Company. If the company had furnished the Commission the information requested relating to the three industrial customers, we would be in a position to make a final determination as to the overall justness and reasonableness of Nashville Gas Company's rates. Since we do not have this information, we are in the unfortunate position of having to act based upon a record which is not complete.

We have previously determined that the company needs additional revenues of $1,147,044 over and above the $1,909,088 in under bond. We believe that the $1,909,088 should be made permanent but a final determination on the justness and reasonableness of the $1,147,044 cannot be made until the company furnishes sufficient information regarding the imputation to Nashville Gas Company of the revenues, expenses, and investment associated with the sale of gas by Tennessee Natural to the three industrial customers located within Nashville Gas Company's certificated area.

MOTIONS AND RULINGS

There are certain procedural matters upon which ruling was reserved by the Commission until this Order. The Commission reserved ruling on the admissibility of the following exhibits: Certain items in Exhibit H-1; Exhibit WB-1; Exhibit DW-1; Exhibit H-10; Exhibit H-11; Exhibit

H-29; Exhibit H-30; Exhibit H-31; and Exhibit H-32. The Commission also reserved ruling on the admissibility of the use of a different test period by the staff. The Commission sustains the objection to Exhibits H-29, Exhibit H-31, and Exhibit H-32, and rules that they should not be admitted into evidence. The Commission is of the opinion that the objections to the above mentioned exhibits, other than the three just sustained, should be overruled and that these exhibits should be admitted into evidence.

IT IS THEREFORE ORDERED:

1. That Nashville Gas Company's revised tariff, as filed on April 14, 1975, in Docket U-6142 be, and the same is hereby, denied.

2. That Nashville Gas Company is hereby authorized to file tariffs with the Commission in Docket U-6098 to produce annual revenue not to exceed $1,909,088, such tariffs to include a reduction in the late payment charge from 10% to 5%.

3. That the Nashville Gas Company shall immediately file with the Commission the following information:

(1) Copies of the presently effective gas sales contracts between the Tennessee Natural Gas Lines, Inc., and its three direct customers located in the certificated area of the Nashville Gas Company, as requested in Item 40(a)(3) of Exhibit H-1.

(2) The information requested on Attachment M as originally requested in Item 40(e) of Exhibit H-1, regarding the income statement and rate base data of the Tennessee Natural Gas Lines, Inc.

(3) The information requested in Item 40(i) of Exhibit H-1, regarding the historical financial data of the Tennessee Natural Gas Lines, Inc.

4. That the Nashville Gas Company is hereby ordered to file with this Commission a proposed tariff which will produce additional annual revenue not to exceed $1,147,044 less the effect of imputing to Nashville Gas Company the revenues, expenses, and investment associated with the sales of gas by its parent, Tennessee Natural Gas Lines, Inc., to the three industrial customers within Nashville Gas Company's certificated area.

5. That the tariffs to be filed by Nashville Gas Company shall become effective upon the approval by this Commission.

6. That all objections and motions not heretofore ruled upon in this Order are hereby overruled.

7. That any party aggrieved with the Commission's decision in this matter has a right of judicial review by filing a Petition for Review in the Chancery Court of Davidson County within sixty (60) days from and after the date of this Order.

/s/ Cayce L. Pentecost
Chairman

/s/ Robert N. Clement
Commissioner

* (See Note)
Commissioner

PREPARED BY GENERAL
COUNSEL'S OFFICE

ATTEST:

/s/ James L. Talbot
EXECUTIVE SECRETARY

* Commissioner Atkins does not concur in this entire decision and will later file a separate opinion concurring in part and dissenting in part.

BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

Nashville, Tennessee

March 13, 1975

IN RE: PETITION OF NASHVILLE GAS COMPANY TO PLACE INTO EFFECT REVISED NATURAL GAS TARIFFS ESTABLISHING RATES AND CHARGES TO PREVENT MATERIAL IMPAIRMENT OF CREDIT AND FOR EMERGENCY HEARINGS THEREON

DOCKET NO. U-6098

ORDER

This matter is before the Tennessee Public Service Commission upon the filing by Nashville Gas Company of a petition to place into effect emergency revised rates for natural gas as set forth in the above caption.

This matter was set for hearing and heard on February 12, 1975, before Chairman Cayce L. Pentecost, Commissioner Robert N. Clement, and Commissioner Z. D. Atkins, at which time the following appearances were entered.

APPEARANCES:

Leslie Enoch, Corporate Counsel, 814 Church Street, Nashville, Tennessee, appearing on behalf of the Applicant.

William W. Bedwell, Attorney, 502 Madison Office Building, 1155 15th St., N.W., Washington, D.C., appearing on behalf of the Applicant.

T. E. Midyett, Jr., Assistant General Counsel, appearing on behalf of the Commission staff.

Nashville Gas Company furnishes natural gas to over 62,000 customers in Davidson County and in portions of Sumner, Cheatham, Williamson, and Wilson Counties. In its petition, Nashville Gas Company requests that it be permitted to place into effect emergency rates designed to produce an annual increase in revenue of $2,591,376.

In requesting emergency relief, the company cited the following reasons for its emergency situation: (1) drastic impact of curtailments in the company's natural gas supply, (2) normal attrition, (3) double-digit inflation, all of which come at a time when the company must refinance $10,000,000 of first mortgage bonds maturing August 1, 1975.

At the hearing on February 12, 1975, the company presented two witnesses, Arnold A. Horner, a consultant with the firm of H. Zinder and Associates, Inc., of Washington, D.C., and W. Crew Anderson, Secretary-Treasurer and Chief Financial Officer of Nashville Gas Company.

The original exhibits filed by Nashville Gas Company with its petition on January 15, 1975, based their requested increase of $2,591,376 on the actual operating results for the 12 months ended November 30, 1974, adjusted for the effects of curtailment of their natural gas supplies. At the hearing on February 12, 1975, the company presented additional exhibits which reflected an adjustment for weather as well as the adjustment for curtailment, which reduced the increase to $1,731,905.

This Commission finds itself faced with the situation where Nashville Gas Company's earnings have been reduced because of several factors, among them a substantial decrease

in its gas supply from its indirect supplier, Tennessee Gas Pipeline Company, in accordance with the orders of the Federal Power Commission, at a time when the company must go to the capital market to obtain $10,000,000 of new financing.

It is the opinion of this Commission, based on the petition filed herein, the testimony of witnesses Anderson and Horner, and the exhibits introduced at the hearing, that Nashville Gas Company should be permitted to place into effect rates to produce an additional $1,731,905 in annual revenue.

The Commission is of the opinion that the rates contemplated herein will be collected by Nashville Gas Company pending a final determination of all pertinent matters in this docket, and will be subject to refund with interest by order of this Commission if any part or all of said rates are ultimately found to be excessive.

IT IS THEREFORE ORDERED:

1. That Nashville Gas Company is granted emergency relief under bond in the amount of $1,731,905 annually.

2. That Nashville Gas Company file tariffs with an effective date which shall coincide with the date of this order.

3. That any portion or all of the revenues granted herein are subject to refund with interest if so ordered by the Commission in its final order in this docket.

4. That Nashville Gas Company shall file a monthly report within 20 days after the close of the month, showing the amount collected in the month, together with the amount collected to date.

5. That this docket shall remain open pending a final determination of the matters contained herein.

/s/ Cayce L. Pentecost
CHAIRMAN

COMMISSIONER

/s/ Z. D. Atkins
COMMISSIONER

PREPARED BY GENERAL
COUNSEL'S OFFICE:

/s/ T. E. Midyett, Jr.
Assistant General Counsel

ATTEST:

/s/ James L. Talbot
EXECUTIVE SECRETARY

BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

Nashville, Tennessee

June 22, 1977

IN RE: PETITION OF NASHVILLE GAS COMPANY TO PLACE INTO EFFECT REVISED NATURAL GAS TARIFFS ESTABLISHING RATES AND CHARGES SO AS TO PERMIT PETITIONER TO EARN A FAIR AND ADEQUATE RATE OF RETURN

DOCKET NO. U-6469

ORDER

This matter is before the Tennessee Public Service Commission upon the filing on May 2, 1977, of a petition by the Nashville Gas Company to increase rates to Nashville customers by $5.5 million, annually.

By Order issued on October 14, 1975, this Commission, in Docket No. U-6142, set just and reasonable rates for the Nashville Gas Company. In this determination the Commission took into consideration the net earnings derived by Tennessee Natural Gas Lines, Inc., the parent company of Nashville Gas, from sales to three direct industrial customers within the certificated area of Nashville Gas. This Order of the Commission was appealed to the Chancery Court of Davidson County, which reversed the Commission. The Commission then appealed this reversal to the Supreme Court of the State of Tennessee which, on March 21, 1977, reversed the Chancellor and found that the Commission did act properly and could and should consider the profits of Tennessee Natural from its sales to the three industrial customers in the certificated area of Nashville Gas. The Supreme Court stated in its opinion at Page 12:

> "It must be remembered, however, that Nashville Gas Company is wholly owned by Tennessee Natural Gas Lines, Inc. Throughout the record and throughout its brief on appeal, appellee stresses the frequent subsidization of the subsidiary by the parent over the years, and it seems to us that the subsidiary in actuality is nothing more than an operating division of the parent. Management decisions, for legitimate reasons, may have placed the industrial sales and the facilities requisite therefore in the parent company, but this does not prevent a public regulatory body from considering them as part of one operating system and taking them into account in determining the proper rate base and rate structure of the subsidiary. Otherwise, it would be a simple matter, through the device of holding companies, spin-offs, or other corporate arrangements, to place the cream of a utility market in the hands of a parent or an affiliate, and to strip the marketing area of a regulated subsidiary of its most profitable customers." Tennessee Public Service Commission vs. Nashville Gas Company ________ Tenn. _____, ______ SW 2d ____ (1977).

On March 31, 1977, Nashville Gas filed a petition for a rehearing before the Supreme Court, which was denied on May 31, 1977.

The present petition requesting a $5.5 million rate increase was filed on May 2, 1977, six weeks after the Supreme Court decision in the prior case. With this petition the company filed its testimony and exhibits in support of the proposed increase. This petition, with accompanying exhibits and testimony, does not contain any information concerning the profits from the three direct industrial customers of Tennessee Natural, which the Supreme Court held that the Commission should consider in determining the justness and reasonableness of rates charged by Nashville Gas.

For this reason we are of the opinion that the filing of May 2, 1977 is fatally deficient.

It is clear that the law of this State, as determined by its highest Court, is that this Commission should consider the profits received by Tennessee Natural from sales to its three direct industrial customers within the certificated area of Nashville Gas. T.C.A. 65-520 places the burden of proving the justness and reasonableness of a proposed rate increase upon the petitioner. The testimony and exhibits filed by Nashville Gas in support of its rate increase do not include information concerning sales to the three direct customers and a review of same indicates that it is clearly inadequate to allow the Commission to determine the justness and reasonableness of the proposed rates.

In order for this Commission to meet its statutory responsibility of setting just and reasonable rates, this information must be furnished and must be included in the testimony and exhibits filed by the company with a rate petition. Rule No. 1220-1-1-.07(4) of the Rules and Regulations of this Commission requires "...in cases of petitions for changes in tariffs or increases in rates, the applicant must file copies of exhibits and prepared testimony simultaneously with the filing of the petition."

This Commission is under a requirement (TCA 65-520) to decide all rate cases within six months of their filing, or the utility can place the rates into effect under bond subject to refund, pending the final decision. If this Commission were not under this requirement to decide this case by November 2, 1977, we could simply at this point require the company to furnish the necessary information and revise its testimony and exhibits accordingly. However, it is impossible for the company to revise its petition, testimony, exhibits and rates and still give the Commission and its staff sufficient time to adequately investigate this matter before the rates could become effective under bond.

Undoubtedly the investigation, including the financial information related to Tennessee Natural, will involve more time and analytical effort than would be the case under normal conditions. Allocation formulae will have to be developed and operational data relating to the three industrial customers will have to be integrated with the financial data shown on the books of Nashville Gas. Due to the anticipated complexity of this investigation, it is the opinion of the Commission that the full statutory period of six months must be available to the Commission and its staff for an adequate investigation in order to have complete and accurate financial data to set just and reasonable rates for Nashville Gas.

For the reasons set out hereinabove, we are of the opinion that the present petition should be dismissed, but that dismissal should be without prejudice to the Nashville Gas Company to refile, if it chooses, a petition with this Commission with rates, testimony and exhibits, including all necessary financial data and information, relating to Tennessee Natural's three industrial customers, which this Commission must consider in setting just and reasonable rates for Nashville Gas. Such filing could then be processed by the Commission within the six-months period of time contemplated by TCA 65-520.

IT IS THEREFORE ORDERED:

1. That the petition of Nashville Gas Company to place into effect revised natural gas tariffs establishing rates and charges so as to permit petitioner to earn a fair and adequate rate of return, be, and the same is hereby, dismissed without prejudice, for the reasons set out hereinabove.

2. That any party aggrieved with the Commission's decision in this matter has a right of judicial review by filing a petition for review in the Chancery Court of Davidson County within sixty (60) days from and after the date of this order.

3. That this docket is herewith closed.

PREPARED BY GENERAL
COUNSEL'S OFFICE

/s/ T.E. Midyett, Jr.
ASSISTANT GENERAL COUNSEL

ATTEST

/s/ James L. Talbot
EXECUTIVE SECRETARY

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/s/ Robert N. Clement
CHAIRMAN

/s/ Z. D. Atkins
COMMISSIONER

/s/ Frank D. Cochran
COMMISSIONER